☐ **EXPEDITE** (if filing within 5 court days of hearing)

☐ Hearing is set:
Date:_____
Time:_____
Judge/Calendar:_____

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF THURSTON

PREMERA, a Washington non-profit miscellaneous corporation; and PREMERA BLUE CROSS, a Washington non-profit corporation,

Petitioners,

v.

MIKE KREIDLER, Insurance Commissioner for the State of Washington,

Respondent.

No. 04-2-01656-5

PETITION FOR REVIEW

PREMERA and Premera Blue Cross (collectively, "Premera") petition for judicial review of an order entered by the Insurance Commissioner of the State of Washington (the "Commissioner") and, pursuant to RCW 34.05.546, state as follows:

I. Name and Mailing Address of the Petitioners

John P. Domeika, Senior Vice President and General Counsel
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II. Name and Mailing Address of the Petitioners' Attorneys

Robert B. Mitchell
Thomas E. Kelly, Jr.
Preston Gates & Ellis LLP
925 Fourth Avenue, Suite 2900
Seattle, WA 98104-1158

III. Name and Mailing Address of the Agency Whose Action Is at Issue

Office of the Insurance Commissioner
P.O. Box 40255
Olympia, WA 98504-0255

IV. Agency Action at Issue

On July 15, 2004, the Commissioner entered his Findings of Fact, Conclusions of Law, and Final Order ("Final Order") in OIC Docket No. G02-45, *In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates*. A copy of the Final Order is attached as **Exhibit A** to this petition for review. (Attachment B to the Final Order has been redacted. It contains proprietary information and, pursuant to the Protective Order entered by the Commissioner in this matter, was designated Attorneys' Eyes Only. Premera is seeking leave to file Attachment B to the Final Order under seal.)

V. Persons Who Were Parties in the Adjudicative Proceedings

A. Premera;

B. Staff of the Office of Insurance Commissioner (the "OIC Staff"), represented by Assistant Attorney General Melanie C. deLeon and Special Assistant Attorney General John F. Hamje;

C. Premera Watch Coalition Intervenor Group, comprising Washington Citizen Action, Welfare Rights Organizing Coalition, American Lung Association of Washington, Northwest Federation of Community Organizations, Northwest Health Law Advocates, Service Employees International Union Washington State Council, The Children's Alliance, Washington Academy of Family Physicians, Washington Association

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of Churches, Washington Protection and Advocacy System, and Washington NOW, joined by Washington Association of Community and Migrant Health Centers, represented by Eleanor Hamburger and Richard E. Spoonemore of Sirianni Youtz Meier & Spoonemore;

D. Hospital Association Intervenor Group, comprising Washington State Hospital Association and the Association of Washington Public Hospital Districts, represented by Michael Madden and Dierk Meierbachtol of Bennett Bigelow & Leedom;

E. Intervenor Washington State Medical Association, represented by Jeffrey Coopersmith; and

F. Alaskan Intervenor Group, comprising the University of Alaska (represented by Ardith Lynch) and United Way of Anchorage, John Garner (a disabled individual), and Anchorage Neighborhood Health Center, represented by Amy McCullough of Alaska Legal Services Corporation.

VI. Facts Demonstrating Entitlement to Review

A. On May 30, 2002, Premera advised the Commissioner that it intended to reorganize certain of the Premera companies from Washington nonprofit corporations to Washington for-profit business corporations. Such a reorganization is colloquially referred to as a "conversion." On September 17, 2002, Premera filed with the Office of the Insurance Commissioner (the "OIC") and the Alaska Division of Insurance (the "ADI") a "Statement Regarding the Acquisition of Control of a Domestic Health Carrier and Domestic Insurer," the formal statement required for approval of Premera's proposed reorganization (the "Form A Statement"). Premera supplemented the Form A Statement on September 27, 2002, and October 25, 2002.

B. On January 3, 2003, Premera petitioned for judicial review of the Commissioner's Third Order: Ruling on Premera's Objections to the Case Management Order. Premera's petition was based upon the Commissioner's refusal to consider

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Premera's Form A Statement within the time frame established by statute and his misinterpretation of the law.[1] On September 5, 2003, Thurston County Superior Court Judge Paula Casey entered an Order setting forth her findings, conclusions, and order remanding the matter with instructions ("Judge Casey's Order"). A copy of Judge Casey's Order is attached as **Exhibit B** to this petition for review. Judge Casey's Order identifies and discusses six errors of law committed by the Commissioner.

C. Among other things, Judge Casey's Order states the following:

- "Review and approval of the Form A Statement is governed by the criteria set forth in the Insurer Holding Company Act, chapter 48.31B RCW (the "Insurer Act") and the Holding Company Act for Health Care Service Contractors and Health Maintenance Organizations, chapter 48.31C RCW (the "Health Care Service Contractors Act") (collectively, the "Holding Company Acts")." Judge Casey's Order, p. 2.
- "In addition to setting forth the required content of a Form A Statement, the Holding Company Acts establish criteria for evaluating a proposed transaction. RCW 48.31B.015(4)(a); RCW 48.31C.030(5)(a)." *Id.*, p. 3.
- "The contents of a Form A Statement are defined by statutes and regulations. The Commissioner has authority to declare whether a Form A Statement is complete. The completeness of a Form A Statement is to be judged solely by its conformity with those sections of the Holding Company Acts and implementing regulations that define the requirements for a complete Form A Statement. *See* RCW 48.31B.015(2)(a)-(l); RCW 48.31C.030(2)(a)-(l); WAC 284-18A-350;WAC 284-18A-910." *Id.*, pp. 5-6.

[1] The Holding Company Acts require the Commissioner to render a decision on a Form A statement within 60 days after declaring it complete. A Form A statement is deemed complete 60 days after its filing unless the Commissioner timely identifies a deficiency in that statement, in which case the initial 60-day period is tolled until 15 days after receipt of the additional information requested by the Commissioner. RCW 48.31C.030(4).

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- "The agency has no authority to interpret the plain language of the Holding Company Acts in a manner that alters or amends the statute." *Id.*, p. 7.

D. On September 12, 2003, Judge Casey approved a Stipulation of Parties and Final Order providing, among other things, that the parties waived any right to appeal Judge Casey's Order.

E. On February 5, 2004, Premera filed Change No. 1 to the Form A Statement (the "Amended Form A Statement") with the OIC and the ADI.

F. On May 3-18, 2004, the Commissioner held an adjudicative hearing on the Amended Form A Statement. On July 15, 2004, the Commissioner issued his Final Order. The last sentence of the Final Order reads as follows: "Premera's Form A request to reorganize, including converting from nonprofit to for-profit status, is hereby DENIED."[2]

G. RCW 48.31B.070(1) provides that a person aggrieved by an order of the Commissioner under the Insurer Act "may proceed in accordance with the Administrative Procedure Act, chapter 34.05 RCW." Similarly, RCW 48.31C.140 provides that a person aggrieved by an order by the Commissioner under the Health Care Service Contractors Act "may proceed in accordance with chapters 34.05 and 48.04 RCW."

H. The Final Order departs materially from the law of the case as established by Judge Casey's Order. As the Final Order reflects, the Commissioner applied decisional criteria different from and in addition to those set forth in the Holding Company Acts. The Commissioner also ruled on matters outside the statutory authority or jurisdiction of his agency. He erroneously interpreted and applied the law. He made factual findings

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[2] The Director of the ADI conducted an adjudicative hearing on the Amended Form A Statement on June 7-11, 2004. The Director issued her Findings of Fact, Conclusions of Law, and Final Order on July 25, 2004. The Director's decision can be found at http://www.dced.state.ak.us/insurance/orders/R03-07.pdf. Unlike the Commissioner, the Director determined that Premera's proposal has several potential benefits. While she felt compelled to disapprove Premera's application in its current form, she concluded that her concerns could be allayed through conditions and/or amendments to the Form A filing.

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that are incorrect and are unsupported by substantial evidence. He failed to make findings on or to decide all issues requiring resolution. The Final Order is arbitrary and capricious.

I. Premera is aggrieved by the Final Order within the meaning of the Holding Company Acts and RCW 34.05.530. The Final Order has prejudiced Premera; Premera's interests as the applicant are among those that the Commissioner was required to consider; and a judgment in Premera's favor would substantially eliminate or redress the prejudice to Premera resulting from the Final Order. Premera therefore has standing to obtain judicial review.

VII. Reasons Why Relief Should Be Granted

A. The Final Order is contrary to Judge Casey's Order and violates the requirements of the Holding Company Acts.

As Judge Casey's Order states, two subsections of the Holding Company Acts—RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a)—establish the criteria by which the Commissioner is required to evaluate Premera's Form A Statement. The Holding Company Acts provide that the Commissioner "shall approve" a Form A transaction unless he makes an adverse finding on one or more of those specific criteria. Particularly given Judge Casey's Order, the Commissioner should have reviewed the language in the evaluative criteria set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a) and applied them as written to the Amended Form A. This he failed to do.

The findings and conclusions in the Final Order do not even address most of the Holding Company Act criteria. Only two criteria from each statute are specifically referenced in the Commissioner's conclusions.[3] The OIC Staff's legal consultant, Patrick Cantilo, conceded at his deposition that a strict interpretation of the Holding Company Acts would not prohibit the transaction proposed by Premera. Ex. P-113, p. 350. Mr. Cantilo testified at the hearing that, in the view of the OIC Staff's consultants, Premera's

[3] Whether these criteria as they appear in the Health Care Service Contractors Act even apply to Premera's Amended Form A Statement is addressed in Part VII.F below.

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Amended Form A Statement satisfies the criteria set forth in the Holding Company Acts. RP 2069-78.[4] Mr. Cantilo devoted most of his attention to matters outside the Holding Company Acts, and the Commissioner, disregarding Judge Casey's Order, followed Mr. Cantilo's lead.

As part of the Amended Form A Statement, Premera proposed to create and fund two foundations to address unmet health and health care needs in Washington and Alaska. Premera proposed to give these foundations 100% of the initial stock in its for-profit successor, subject to the terms and conditions in the Amended Form A Statement. More than a third of the findings in the Final Order[5] focus on the terms of this stock transfer. The Commissioner asserts that, as a prerequisite to conversion, Premera must convey its "fair market value" to the Washington and Alaska foundations. Neither the phrase "fair market value" nor the legal standard implied by that phrase can be found in the Holding Company Acts.

The phrase "fair market value" comes from the Acquisition of Nonprofit Hospitals Act, RCW 70.45.070(5). The OIC Staff's legal consultant suggested in his reports that this statute could be applied by analogy to the present case. The evidence presented to the Commissioner, however, showed that it is wholly inapplicable:

- The Acquisition of Nonprofit Hospitals Act by its terms applies only to nonprofit hospitals that propose to convert to for-profit status. *See* Ex. P-87, p. 9.
- Chapter 70.45 RCW is drawn from a model act that encompassed, in addition to hospitals, nonprofit health care service contractors. The Legislature rejected

[4] Mr. Cantilo identified only one concern, which relates to the interests of subscribers and the insurance-buying public: the impact of conversion upon the market for individual and small group coverage in Eastern Washington, after Premera's economic assurances expire. This issue is discussed in Part VII.D.1 below. Mr. Cantilo assumed for purposes of his testimony that the reference to "public interest" in RCW 48.31B.015(4)(a)(iv) and RCW 48.31C.030(5)(a)(ii)(C)(II) must be read in conjunction with the welfare of subscribers.

[5] Findings 89-152. Many of these findings (e.g., no. 91) are poorly disguised conclusions of law. Among the acknowledged legal conclusions, nos. 5 and 13-16 all assert or are premised upon the assertion that Premera has an obligation to convey "fair market value."

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applying ch. 70.45 to companies such as Premera by specifying that it would apply to hospitals alone. *Id.* at 9-10.

- The Legislature enacted ch. 70.45 RCW several years before it passed the Health Care Service Contractors Act. When it passed the Health Care Service Contractors Act, the Legislature again eschewed applying to companies such as Premera the standards found in ch. 70.45 RCW. *Id. at* 10-11; RP 2456.
- The "fair market value" test in the Acquisition of Nonprofit Hospitals Act is intended to "safeguard the value of charitable assets and ensure that any proceeds from the acquisition are used for appropriate charitable health purposes." RCW 70.45.070; *see also* Ex. 87, pp. 11-12. As discussed in Part VII.B below, Premera does not have charitable assets.

Given that the factual predicate for applying a "fair market value" test in the case of nonprofit hospital acquisitions—namely, the fact that they have charitable assets—is absent here, and given that the statute in which that test appears is plainly not applicable to other nonprofit corporations, the Commissioner should have rejected the suggestion that he apply such a test to Premera's Amended Form A Statement. The mandate in Judge Casey's Order that he evaluate the proposed transaction under the criteria set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a) should have produced the same result, for neither of these provisions establishes "fair market value" or anything like it as a basis for evaluating a Form A statement.[6]

[6] As part of the review of its proposal by the OIC and the ADI, Premera has been required to pay all fees charged by consultants to those agencies. *See* RCW 48.31C.030(5)(b); AS 21.22.030(d). Premera would have saved a large share of the more than $18 million that it has been forced to pay these consultants, had they focused their attention upon the criteria in the Holding Company Acts as Judge Casey's Order directs, rather than "fair market value" and related issues. *See, e.g.,* RP 1443 (OIC Staff's investment banking consultant alone charged over $5 million); RP 1405-06. 1487-89 (in reviewing transaction terms, investment banking consultant assumed that the public owns Premera and did not consider the interests of subscribers or the insurance-buying public). Finding 19 blames Premera for the excessive costs of its conversion effort, without acknowledging the largest component of those costs (namely, the states' consultants) or the regulators' responsibility for the scope of the consultants' review.

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Rather than abandon "fair market value" as inapplicable to this transaction and beyond the scope of the statutory criteria identified by Judge Casey, the Commissioner instead seeks to find support for a "fair market value" test in a potpourri of other sources. Among other things, the Commissioner purports to rely upon sections of the Holding Company Acts different from those set forth specifically in Judge Casey's Order as establishing criteria for evaluation of Premera's Amended Form A Statement. He asserts that these sections somehow support his notion of "fair market value." He is mistaken, and his attempted use of these sections manifests legal error.

First, the Commissioner cites RCW 48.31C.030(2)(b) for the proposition that his examination of the "source, nature, and amount of the consideration used or to be used in effecting the acquisition of control" means that he must review the terms of every acquisition transaction. Finding 102. Even if this is true, it does not mean that the Commissioner's review of transaction terms creates an obligation to transfer "fair market value" or that such a standard can serve as a basis for disapproving a Form A statement. Indeed, the Insurer Act does not authorize the Commissioner to disapprove a proposed acquisition on the basis that he believes the amount paid should be greater, unless he reasonably concludes that the transaction is both unfair and unreasonable to subscribers and not in the public interest.[7] In this case, there is no evidence that Premera's subscribers are harmed by restrictions upon the stock that Premera proposes to give the foundations. On the contrary, as the Commissioner acknowledges, they would be harmed if those restrictions were removed. *See* Finding 178.

Second, the Commissioner drops a footnote citing RCW 48.31B.030 and RCW 48.31C.050, the statutes governing intercompany transactions (termed "Form D transactions"), as authority permitting him to determine whether the terms of an

[7] Under the Health Care Service Contractors Act, the Commissioner does not even reach this criterion unless there is a threshold finding of antitrust injury. *See* Part VII.F below.

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acquisition (i.e., a Form A transaction) are fair and reasonable. Final Order at 37 n. 27. The Commissioner's conclusory footnote, and the conclusions in the Final Order that rely in part upon RCW 48.31B.030 and RCW 48.31C.050 (nos. 5, 13, 14, 15, 16, and 17), plainly violate the law of the case doctrine, because they are contrary to Judge Casey's Order.

Even if Judge Casey's Order is put to one side, Form D standards do not apply to Premera's proposed conversion, which is a Form A transaction. The testimony at the hearing established not only that the terms of the intercompany transactions proposed by Premera are fair and reasonable, but also that such transactions are distinct from the acquisition of control that underlies Premera's Form A Statement.[8] In any case, the Commissioner cites no authority for the proposition that "fair and reasonable terms" means the same thing as "fair market value," particularly where there will be no market by which the "fair market value" of Premera's stock can be measured unless the transaction proceeds.

In addition to trying to change the statutory criteria for evaluating a Form A statement, the Commissioner demonstrates his disregard for Judge Casey's Order by making Finding 177, which asserts that Premera's plan of conversion suffers from a fatal "deficiency" because it fails to spell out precisely how Premera will spend the capital that it proposes to raise at an IPO.[9] Judge Casey's Order instructed the Commissioner nearly a

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[8] *See* RP 1586; RP 2078-80. There was only one concern expressed at the hearing about any Form D transaction: Mr. Cantilo wanted the terms of Premera's guarantee to its Washington subsidiary to mirror the terms of its guarantee to its Alaskan subsidiary. This could, he testified, be easily accomplished by a condition requiring Premera to guarantee replacement of coverage in Washington, as it had in Alaska. RP 2042; RP 2078-80. Premera advised the Commissioner that it would accept such a condition. RP 1141-42; Premera's Post-Hearing Brief at 15 n.28. (Premera incorporates its hearing brief and post-hearing briefs herein by reference.)

[9] Premera's reasons for raising capital and its planned use of the proceeds are discussed in Part VII.C.2 below.

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year ago to identify any deficiencies in Premera's Form A Statement.[10] The Commissioner failed to identify the deficiency asserted in Finding 177 then, and it is not timely for him to do so now. Moreover, Judge Casey's Order provides that the completeness of a Form A Statement must be judged "solely by its conformity with those sections of the Holding Company Acts . . . that define the requirements for a complete Form A Statement." The Commissioner does not identify any requirement for a complete Form A Statement left unmet by Premera's plan of conversion. This is unsurprising, because there is none.

B. The Commissioner has acted outside his statutory jurisdiction and erroneously interpreted Washington law.

In addition to violating Judge Casey's Order by applying criteria to Premera's Amended Form A Statement other than those set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a), the Commissioner has ventured outside his statutory jurisdiction and, once there, has committed legal error. For these reasons as well, the Final Order must be reversed.

The touchstone of review of Form A transactions under the Holding Company Acts is the protection of subscribers and potential subscribers. One criterion asks whether the plans of the acquiring party to make any material change in the business, structure, or management of the existing carrier "are unfair and unreasonable to policyholders and not in the public interest." RCW 48.31B.015(4)(a)(iv).[11] Another asks whether the

[10] In response, the Commissioner identified three purported deficiencies. He abandoned one of these after Premera pointed out that the information in question had been provided some nine months earlier. Although Premera did not agree that the other two items cited by the Commissioner represented actual deficiencies in the Form A Statement, Premera supplied all the information identified by the Commissioner by February 5, 2004, when it filed its Amended Form A Statement.

[11] The conjunction "and" (also found in RCW 48.31C.030(5)(a)(ii)(C)(II)) signifies that a proposal cannot fail this test unless it adversely affects policyholders (subscribers). The Commissioner, however, appears to interpret the quoted language as authorizing him to consider the interests of "the general public" quite apart from subscribers or the insurance-buying public. Conclusion 2; *see also* Conclusion 3. This is inconsistent with the Holding Company Acts. It also violates Judge Casey's Order, which holds that the

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acquisition is "likely to be hazardous or prejudicial to the insurance-buying public." RCW 48.31B.015(4)(a)(vi). Neither invites the Commissioner to consider other interests, except insofar as perceived unfairness to policyholders might be outweighed by considerations of the public interest.[12]

1. The Commissioner wrongly suggests that Premera is subject to the law governing nonprofit charities and ignores undisputed evidence that Premera's assets are not charitable.

In addition to citing the Holding Company Acts, the Commissioner states that the Washington nonprofit corporation laws (chs. 24.03 and 24.06 RCW) apply to the Amended Form A Statement. He interprets those statutes as imposing requirements upon Premera in addition to those set forth in the Holding Company Acts. Interpretation and enforcement of statutes governing for-profit and nonprofit corporations rest principally if not exclusively with the courts, the Secretary of State, and the Attorney General. *See, e.g.*, RCW 24.03.440, RCW 24.03.040(3).[13] The Commissioner errs by acting outside his

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Commissioner "has no authority to interpret the plain language of the Holding Company Acts in a manner that alters or amends the statute."

The Commissioner's errors are manifest in Conclusions 14, 15, and 16, all of which state that the Amended Form A "is not fair and reasonable to the *public* and not in the public interest." (Emphasis added.) As such a statement implicitly concedes, and as the record unambiguously establishes, there is no unfairness or unreasonableness to *subscribers* arising from (a) the alleged failure to transfer "fair market value," (b) the alleged dilution of the value of the foundations' shares, or (c) restrictions upon the foundations' ability to vote and trade their shares of stock. None of these considerations, therefore, can be a legitimate basis for disapproving the Amended Form A Statement.

[12] The public interest in insurance is defined in RCW 48.01.030. In addressing this public interest, it would be appropriate to consider the advantages of having available large new sources of philanthropy to address unmet health needs. The OIC Staff's expert on tax-exempt foundations agreed with Premera's expert that the conversion transaction proposed by Premera "serves the public interest by permitting Premera to continue as a vital company with access to the capital markets, while unlocking the charitable potential in its assets by adding two new large sources of philanthropic health funding in the states of Washington and Alaska." RP 1563-64; *accord*, Ex. P-11, p. 3. As discussed in Part VII.C.1 below, the Commissioner utterly fails to address this testimony or the public benefits of the proposed foundations.

[13] The Commissioner relies upon his interpretation of the Washington *for-profit* corporation statute (Title 23B RCW) in Finding 48, which concerns a potential acquisition of Premera after conversion. His legal conclusion there is erroneous. *See also* discussion of autonomy in Part VII.C.2 below.

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statutory jurisdiction. Perhaps more importantly, he misinterprets and misapplies the corporate statutes that he invokes.

At the outset of this case, directly contrary to what Premera told him, the Commissioner assumed that Premera's assets could be used only for charitable purposes. His lawyers may have been responsible for the Commissioner's erroneous assumption; in any case, they failed to correct it. A memorandum provided to the Commissioner from the Attorney General's Office dated October 15, 2002, cites RCW 24.03.225 for the proposition that "the Attorney General must approve any plan of distribution of assets *the use of which is limited to charitable or other similar purposes*." Ex. I-2, at 4 (emphasis added). This much is accurate. The memorandum continues, however: "Thus, under the law, *any transfer of the assets of Premera* to another entity will require the Attorney General's approval." *Id.* (emphasis added). The memorandum assumes, in other words, that all of Premera's assets are limited to charitable uses. This assumption is false. Indeed, the evidence indicates that the State's lawyers harbored serious doubts about the validity of that assumption but did not want to admit such doubts publicly.[14]

Based upon its false assumption that Premera's assets are charitable, the memorandum from the Attorney General's Office suggests that the Commissioner "may review the valuation of the company and whether the value is preserved for use in accordance with the law." *Id.* at 1. The Final Order reflects that the Commissioner sought to do this—despite undisputed evidence that Premera is not a charity, its assts are not limited to charitable uses, and such assets need not be "preserved for [charitable] use."

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[14] *See* email exchanged by Assistant Attorney General Rusty Fallis and Patrick Cantilo in early 2003 (Ex. P-134—e.g., Premera "is patently not a typical charity"; Ex. P-141—e.g., "our considerable uncertainty as to whether Premera is a charitable corporation"). In his deposition, Mr. Cantilo testified that he was instructed to assume that the public owns Premera and that its assets are charitable. *See* Ex. P-112, p. 57; Ex. P-113, pp. 280-83. Mr. Cantilo's reports are predicated upon this assumption, which is the sole basis for his claims that Premera has a "fundamental legal obligation" to transfer "fair market value." *See, e.g.,* Ex. P-110, pp. 96, 213-14; Ex. P-112, pp. 83, 147-48.

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The testimony in this case reflects the following, among other things:

- Premera does not operate and has not operated as a charity but rather as a commercial enterprise offering health care coverage to paying customers. *See, e.g.*, Ex. P-7; RP 97-99; RP 124-25; RP 1260.
- Premera is not a public benefit corporation under Washington law. Ex. P-87, p. 5.
- Premera's assets reflect its receipt of policy premiums over many years. Those premiums were not gifts, and the assets were not received nor have they been held subject to limitations requiring that they be used only for charitable purposes. *Id.* at 12, 14-15.
- Premera's assets are not encumbered with any charitable trust obligations. Even if there were some such assets, their presence would not render Premera a charity or cause its other assets to be charitable. *Id.* at 15; RP 1269-70..

The Commissioner fails to make any findings regarding this testimony. That failure reflects legal error. *See White Glove Bldg Maint. v. Brennan*, 518 F.2d 1271 (9th Cir. 1975).[15] The Commissioner's error is compounded by numerous findings and conclusions that serve to obscure rather than illuminate the question of whether Premera is a charity. For example, Finding 92 states that "[n]either Premera nor the OIC Staff undertook the legal and factual analysis to determine if Premera's assets are held as a charitable trust under Washington law." In addition to assuming incorrectly that a Form A applicant has an obligation to undertake such an analysis, Finding 92 ignores Premera's presentation at the hearing of its factual and legal analysis on that very question.[16] The Commissioner also finds that "Premera submitted the Form A to the Attorney General for

[15] By contrast, the director of the ADI determined, after a public hearing in which the same evidence was presented, that Premera's assets are not subject to a charitable trust. *See* http://www.dced.state.ak.us/insurance/orders/R03-07.pdf, p. 52.

[16] It is true that the OIC Staff undertook no such analysis. Instead, the OIC Staff assumed that Premera's assets are charitable, instructed its legal consultant to make the same assumption, and ignored Premera's repeated advice that the assumption was false. *See* Ex. P-112, pp. 38-39; Ex. P-113, pp. 280-83.

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review pursuant to RCW 24.03.230, thereby acknowledging her authority to review Premera's plan of distribution of assets in accordance with RCW 24.03.225(3) [concerning charitable assets]." Finding 99. The evidence showed, however, that Premera did not submit its Form A Statement to the Attorney General for review under RCW 24.03.230 and that it never conceded the Attorney General's authority to conduct a review of its eventual dissolution under RCW 24.03.225(3).[17]

2. The Commissioner's asserted bases for applying a "fair market value" test are illusory.

The Commissioner does not find that Premera is a charity, but he fails to make a straightforward finding that Premera is *not* a charity. The reason for this failure is that the OIC Staff's false assumption of charitable status is the unacknowledged premise for the repeated assertion in the Final Order that Premera has a legal obligation to transfer "fair market value." Rather than admit that the factual basis for imposing a "fair market value" standard has been proven to be false and that the statute from which that test is drawn (RCW 70.45.070) has no application to this case, the Final Order seeks to draw support for a "fair market value" test from other sources. That effort is unavailing and entails numerous further errors.

The Commissioner asserts that "[t]he terms of the Form A and representations made to me and the Attorney General, Premera's and its parent's articles of incorporation, the Washington nonprofit corporation law . . . and the Holding Company Act . . . each independently and in combination require that the fair market value of New PREMERA be transferred to the Washington and Alaska Foundations." Conclusion 5. This

[17] The Commissioner's findings on related matters are replete with legal and factual errors. For example, Finding 94 states that "Premera's predecessor was formed in 1945 by the Washington Hospital Service Association under the charitable corporation laws . . . ." In reality, the Washington Hospital Service Association *was* Premera's predecessor. More importantly, it was *not* formed under the charitable corporation laws. Finding 99 is flatly wrong; Finding 100 omits the critical passage in Premera's letters to the Attorney General and the Commissioner stating that it is not a charity.

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conclusion is erroneous. The phrase "fair market value" cannot be found in any of the documents or statutes cited by the Commissioner. Indeed, the terms of the Amended Form A Statement set forth the very plans of Premera and restrictions on the voting and sale of foundation stock that, according to the Commissioner, transgress his "fair market value" test. There have been no "representations" to the Commissioner or to the Attorney General inconsistent with those terms.[18]

The Commissioner fails to identify anything in Premera's articles of incorporation or the nonprofit statutes that might be thought to create a legal obligation to transfer "fair market value." There is no such obligation. RCW 24.03.225(5) provides that, upon dissolution, any assets of a nonprofit corporation remaining after (1) payment of liabilities, (2) return or transfer of any assets that were held upon condition requiring their return or transfer, (3) transfer to charity of any assets that were received and held subject to charitable use limitations, and (4) distribution to members or others as required by the articles or bylaws

> . . . may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or not for profit, as may be specified in a plan of distribution adopted as provided in this chapter.

RCW 24.06.265(3) provides that, upon dissolution, the corporation's remaining assets "shall be distributed to the members, shareholders or others in accordance with the

[18] Premera explicitly advised both the Commissioner and the Attorney General in May 2002 that it is not a charity. In the Amended Form A, Premera said that it would give the Washington and Alaska foundations 100% of the initial stock of New PREMERA, subject to the terms set forth in the Amended Form A Statement. Neither the foundations or the Commissioner, purporting to act on their behalf, is entitled to dispute the terms under which such stock is conveyed because it fails to provide "fair market value." To do that requires an assumption that Premera's assets are charitable or that the public already owns Premera, which would be an error of law. *See, e.g.,* Finding 108 (mistakenly assuming that, because a nonprofit corporation is not owned by management or shareholders, it is owned by the public). Moreover, even if (contrary to fact) Premera had suggested that it intended to transfer "fair market value" to the foundations, it would not follow that Premera has a legal obligation to do so.

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provisions of the articles of incorporation." Premera's current articles direct that its assets should be distributed upon dissolution to one or more nonprofit entities.

In the proposed transaction, Premera's assets at the point of dissolution will consist solely of the stock of New PREMERA. That stock, representing the entire ownership interest in New PREMERA, will be distributed to nonprofit, tax-exempt foundations, consistent with the statutes and articles quoted above. Neither the nonprofit statutes nor Premera's articles refer to "fair market value"; neither prohibits distributing assets subject to conditions and restrictions.[19] If Premera's articles actually had any provision that supported the Commissioner's concern, that provision could be amended at the discretion of Premera's Board. *See* RCW 24.03.160, 24.03.165; RCW 24.06.185, 24.06.190.

The Commissioner finds that he "must also consider Premera's obligations to comply with its own Articles of Incorporation and the Washington Nonprofit Corporation Act," lest Premera's actions later be challenged and overturned. Finding 110. It is the Attorney General, however, who has express authority under RCW 24.03.040(3) to determine whether a nonprofit corporation is acting *ultra vires*. More importantly, the Commissioner fails to suggest any basis for concluding that the Amended Form A Statement fails to comply with Premera's articles or with the nonprofit statutes. Because there is none, the Commissioner's finding amounts to baseless innuendo.

3. The Commissioner's legal errors produce absurd results.

The Commissioner makes a host of findings on issues subsumed under his "fair market value" criterion. Many of these are erroneous for reasons in addition to the legal error infecting their major premise. For example, Finding 123 ignores undisputed

[19] Indeed, under the amended articles of incorporation of PREMERA that are part of Premera's Form A, such distribution of assets "shall be subject to . . . any contractual obligations associated with the Foundations' receipt of such proceeds." Exhibit C-2 (Amended Form A Statement), Exhibit A-2, p. 8.

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testimony on communications with the Blue Cross Blue Shield Association ("BCBSA"),[20] and Finding 130 misconstrues the limitations in the BCBSA license agreement. What is striking from a broader perspective is that the Commissioner's errors of law lead to results that can only be termed absurd. For example:

- The Commissioner expresses concern that the foundations might receive too little, and therefore concludes that they should receive nothing.
- The Commissioner finds that any restriction on the stock to be given to the foundations reduces the value of that stock, despite undisputed evidence that such restrictions can serve to enhance stock value.
- The Commissioner focuses upon issues that, according to the OIC Staff's as well as Premera's investment banking experts, pale in comparison with the value to the company and its shareholders (including the foundations) of a continued right to use the Blue Cross and Blue Shield marks, yet he determines that the license to the Blue marks would have to be sacrificed in order to address his concerns.[21]
- In considering "fair market value" issues, the Commissioner ignores altogether the interests of subscribers and the insurance-buying public—that is, the very interests that the Holding Company Acts are designed to protect.[22]

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[20] The BCBSA is the owner of the Blue Cross and Blue Shield trademarks. The BCBSA licenses those marks to entities that, as a condition of maintaining their right to use the marks, must comply with various licensing standards and other requirements adopted by the BCBSA. Premera is a licensee of the Blue marks in Alaska and substantially all of Washington.

[21] By contrast, the Director of the ADI determined that conditions upon approval of Premera's proposal should be crafted to avoid loss of the Blue marks. *See* http://www.dced.state.ak.us/insurance/orders/R03-07.pdf, pp. 44-46, 66-70.

[22] The Commissioner states in Finding 178 that his concerns about "fair market value" can be addressed only by changes in transaction terms that jeopardize the Blue marks, to the great detriment of Premera's subscribers and the insurance-buying public. This is a classic Catch-22.

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C. The Commissioner has improperly ignored and rejected undisputed evidence showing the benefits of Premera's proposal.

1. The Commissioner ignores the benefits of the new foundations.

The Commissioner's focus upon issues that, he says, detract from the transfer of "fair market value" leads him to overlook completely the value of a foundation devoted to addressing the unmet health needs of Washington residents. There was substantial undisputed testimony at the hearing, from multiple witnesses, about the nature and magnitude of such needs and the great benefit that the foundations could provide in helping to address them.[23] The OIC Staff's investment banking consultants suggested that the combined endowment of these foundations could be in the range of $500 to $700 million, which would (on a per capita basis) make them among the largest foundations ever created in a health care conversion.

About all this the Commissioner says only the following: "The failure of Premera to transfer fair market value would undermine any possible mitigation that the creation of a Washington Foundation could have . . . ." Finding 152. Quite aside from the errors that undermine the Commissioner's reliance on and assessment of "fair market value," his failure to make findings on the extent of unmet health needs in this state and the great value that this new source of philanthropy could have in addressing such needs, together with his failure to weigh those benefits against his stated concerns about the conversion, violates his legal obligation in this proceeding. The Holding Company Acts, to the extent that they authorize disapproval of a Form A statement in the circumstances present here, require the Commissioner to consider whether the benefits of the proposal could outweigh its perceived unfairness to subscribers. It is only if he reasonably finds the plans of an

[23] Sally Jewell testified that the foundations would make "an amazing difference" in "addressing many of the challenges that we are feeling as a state." RP 84-85. Barbara Dingfield and Lewis Reid both offered compelling testimony on the improvements in health status and health care that could result from the creation and funding of the Washington foundation as proposed in the Amended Form A Statement. *See, e.g.*, Exs. P-8, P-11, P-12, P-15; RP 245-60, 279-303. There was no contradictory testimony.

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acquiring entity are unfair and unreasonable to subscribers *and* not in the public interest that he is entitled to reject a proposal on grounds of subscriber harm.[24] Second, a trier of fact in an administrative proceeding may not ignore uncontradicted evidence unless he provides reasons for finding it unpersuasive. No reasons are offered here, and none are imaginable.

The Commissioner's complete failure to consider the public benefits of the Washington foundation means that each of his conclusions purporting to evaluate the impact of the conversion on Premera's subscribers, the insurance-buying public, and/or the general public is fatally flawed. He simply did not weigh the undisputed benefits of the foundations against his purported concerns with Premera's proposal.[25]

2. The Commissioner ignores and misstates evidence showing the benefits of Premera's proposal to the company, its subscribers, and the insurance-buying public.

The Commissioner's treatment of the reasons for, and benefits of, conversion demonstrates an equally one-sided approach. His evaluation of what he terms "Premera's primary stated reasons for conversion" (Finding 17) seeks to discount each potential reason for pursuing the transaction, so that he can claim that there are no benefits to offset what he sees as potential harms. The Commissioner's findings on this subject are not supported by substantial evidence. Moreover, he fails to make other findings reflecting the undisputed evidence in the record on the benefits of Premera's proposal.

The first reason that Premera seeks to convert to a for-profit company with access to the equity capital markets is to strengthen its capital reserves—that is, to increase its

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[24] An agency's failure to decide all issues requiring resolution by the agency merits relief under RCW 34.05.570(3)(f).

[25] By contrast, the Director of the ADI observes that "Premera's proposal presents a potential for significant benefits to Alaska. . . . The funding of an Alaska Health Foundation as part of the conversion plan presents a significant opportunity to impact the unmet health needs in this state." *See* http://www.dced.state.ak.us/insurance/orders/R03-07.pdf, p. 1.

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Risk-Based Capital ("RBC").[26] *See* RP 117-18. The Commissioner acknowledges that Premera's RBC is well below the average of other Blue Cross plans, but he emphasizes that its situation is not desperate. He fails to acknowledge uncontradicted testimony that, under a variety of positive and negative scenarios, Premera's RBC could fall below the BCBSA early warning level. He fails to make findings on the benefits of having more capital than the minimum. He fails to reflect the undisputed evidence that one of Premera's main competitors (Regence) has much higher RBC. In finding that Premera could raise its RBC through debt or surplus notes, the Commissioner also errs. The record establishes that debt does not increase RBC. Surplus notes have many drawbacks, not the least of which is that they can be used to raise statutory capital and thus RBC only to a very limited degree.

The Commissioner fails to make any finding that reflects the undisputed testimony about the benefits to Premera's subscribers and the insurance-buying public of strengthening Premera's capital reserves, starting with greater security for subscribers' health insurance coverage. *See, e.g.,* RP 116. The Commissioner also fails to make findings based on the unanimous testimony of, among others, Jonathan Koplovitz (the OIC Staff's investment banking consultant) that Premera would benefit not only from having more capital in the short term but also from being able to access the capital markets in the future, as well as that it would be difficult for Premera to use any other methods to raise its RBC significantly. *See* RP 1384-88, 1421-22.

The second reason Premera seeks to convert is that having additional capital will support subscriber growth. The undisputed evidence shows that growth requires greater

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[26] RBC is determined by a formula reflecting an insurer's capital position relative to various risks faced by that insurer, including underwriting risks, asset risks, and credit risks. State insurance regulators require insurers to report RBC annually. The regulators use such reports to monitor capital adequacy. If an insurer's RBC falls below a certain level, the insurer becomes subject to increased oversight by state insurance regulators, including possibly receivership. The BCBSA uses RBC levels to monitor its licensees and to avoid potential regulatory action against them, for that could harm the Blue marks.

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capital reserves. *See, e.g.*, RP 119-20. The insurance-buying public plainly benefits from membership growth: by definition, such growth means that more people are taking advantage of products and services that they find desirable. Subscribers also benefit from membership growth: as the number of members grow, the costs of technology and infrastructure improvements and other administrative costs are spread over a broader base. There was no testimony at the hearing that contradicted Premera's analysis of how increased capital reserves are needed in order to permit the company to grow its membership. The Commissioner, however, belittles such evidence as reflecting Premera's "belief" (Finding 33), and he fails entirely to include this factor in his evaluation of the costs and benefits of conversion to Premera's subscribers and the insurance-buying public.[27]

Premera's third reason for conversion is that funds accessed through the equity capital markets will permit the company to improve its products and services, to the benefit of its subscribers and the insurance-buying public alike. The Commissioner discounts this reason because, he says, Premera "has not developed any specific product or service projects that it would implement if it had access to capital through the equity markets." Finding 30. This complaint fails on three grounds. First, it is inaccurate. Many witnesses testified about specific products and projects that Premera could undertake with added capital.[28] To expect greater precision about potential investments, more than a year before any actual investment decisions can be made, is to ignore business realities and to demand the impossible. Second, the Commissioner appears to have assumed, wrongly, that there must be specific plans for all of the new capital. In

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[27] In Findings 34-36, the Commissioner focuses on Premera's growth strategy for administrative service contracts, which is a relatively small part of Premera's business. He suggests both that this business does not require RBC and that it is not profitable. Both suggestions are erroneous. In addition, this discussion is a distraction. It does not and cannot provide a basis for ignoring the benefits of Premera's proposed conversion.

[28] *See, e.g.*, RP 120-21; RP 930-41; RP 955-77; RP 2471-72; Ex. P-4 at 12-13; Ex. P-40; Ex. P-68 at 7-8. *See also* Ex. C-2 (Amended Form A Statement), Exhibit E-7.

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reality, spending every dime of new money would be inconsistent with the first reason for seeking capital—namely, to increase capital reserves. Third, even if the Commissioner's complaint had merit, there is nothing in the Holding Company Acts that authorizes the Commissioner to deny conversion because he thinks that the company should have been more specific in identifying the types of products and services it expects to develop in the future.

In addition to the three principal reasons for conversion discussed above—namely, strengthening capital reserves, growing membership, and improving products and services—the Commissioner cites three other "stated reasons" in Finding 17. These he misapprehends or misrepresents. First, the Commissioner suggests that conversion could help Premera preserve its autonomy. To be sure, members of the Premera Board testified that, in their judgment, Premera can best serve its customers at this time by remaining a strong, locally based company. But neither they nor anyone else associated with Premera has suggested that maintaining autonomy is an end in itself.

The Commissioner offers a lengthy discussion of what other Blue plans have done after they converted. He observes that a number of them later acquired other companies or were themselves acquired. He then leaps to the conclusion that, if Premera is allowed to convert, there is a "high likelihood" of acquisition by a national insurer. Finding 47. This is rank speculation.

Nowhere does the Commissioner find that there is anything inherent in Premera's conversion that would make it likely to lose its autonomy. He ignores undisputed evidence that Premera's conversion plan incorporates specific anti-takeover provisions available under Washington law. He ignores the ability of the foundations to vote freely on any such proposal. Even more astoundingly, the Commissioner ignores the fact that he holds in his own hand the key to any proposed merger after Premera's conversion. That is, if Premera sought to merge with another company, or if another company sought to

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acquire Premera, a new Form A statement would have to be filed for the Commissioner's review and decision, based upon the same statutory criteria that apply to this proceeding. The Commissioner's rationale here seems to be "stop me before I have an opportunity to approve or disapprove a future hypothetical merger." Whatever his thinking is, it does not form a proper basis for disapproving Premera's Amended Form A Statement.

The Commissioner's approach to a second issue—namely, leveling the playing field among competitors offering health insurance in Washington—disregards the key, undisputed facts about capital reserves. Whether an insurer has a nonprofit or a for-profit corporate structure does not, by itself, determine whether it can compete effectively. What matters is whether the insurer has ample capital available or can readily access such capital. The evidence showed that Premera faces competition from large out-of-state, for-profit carriers, all of which have access to equity capital. The evidence also showed that Premera's principal nonprofit competitor in Washington, Regence, has a significantly higher RBC level and, therefore, much more capital than Premera. Permitting Premera to have access to the equity markets would level the playing field relative to all these rivals.

The Commissioner lists, as the last of the "primary stated reasons for conversion," improved management retention. Finding 17; *see* Finding 51. This is a straw man, erected only for the purpose of knocking it over. Premera's Amended Form A Statement says nothing on the subject of management retention. There is also no evidence that Premera ever gave improved management retention as a reason for conversion. Hence, the Commissioner's discussion of this subject contributes nothing to an analysis of whether there are real benefits to conversion for Premera, its subscribers, and the insurance-buying public.

Finally, Findings 53 and 54 address the subject of "strategic flexibility," i.e., the ability to return to the equity markets at later dates as capital needs or opportunities arise. A public company can do this; a nonprofit cannot. In consequence, a capital crunch can

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send a nonprofit into a downward spiral. Jonathan Koplovitz, among other witnesses, identified strategic flexibility as a significant benefit of conversion. There was no evidence to the contrary. The Commissioner, however, characterizes the benefits of strategic flexibility as "speculative." Like the benefits to be derived from a stronger capital base, the ability to support membership growth, and improved products and services, the benefits of strategic flexibility are anything but "speculative." They are undeniable. The Commissioner's finding that the strategic benefits are "speculative" is without any basis in the evidence.

D. The Commissioner has erred in making findings and conclusions regarding the economic impact of Premera's proposal.

The Commissioner concludes that Premera's proposed conversion is unfair and unreasonable to subscribers, not in the public interest, and likely to be prejudicial to the insurance-buying public because (1) premiums in the individual and small group markets will likely increase in Eastern Washington counties in which Premera has market power as a consequence of the conversion, (2) Premera's medical loss ratio will likely decrease as a consequence of the conversion, and (3) the economic assurances provided by Premera are mostly ineffective. *See generally* Conclusions 7-10. These conclusions, and the findings on which they purportedly rest, are not supported by substantial evidence and are infected by errors of law.

1. Premiums

The Commissioner's determination that Premera will likely increase premiums for its individual and small group products in certain Eastern Washington counties is based on the analysis by PricewaterhouseCoopers (PwC). *See* Finding 78; Conclusions 7, 8. That determination is not supported by substantial evidence; rather, it is contrary to undisputed evidence:

- The PwC economic impact consultants' assumption and the Commissioner's related finding that Premera must increase premiums to meet target margins as

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demanded by shareholders (RP 1699-1702, Finding 59) is speculative and is contradicted by the testimony of the OIC Staff's investment banking expert, Jonathan Koplovitz. RP 1389; *see also* RP 169-1701.

- PwC's analysis and the model on which it is based do not predict that individual and small group premiums are likely to rise. The model merely calculates the amount by which premiums would have to rise to meet target margins. RP 1991-92; RP 1730-31. Further, the model fails to take into account realistic competitive conditions. It incorrectly assumes that Premera has market power in any county in which market share exceeds 65%, and it fails to account for any regulatory constraints on rate setting. RP 1729-31; RP 1991-99. The PwC witnesses responsible for the analysis and the model, who were found to be credible (Finding 57), admitted that their work has no predictive value. RP 1730-31; RP 1991-99.
- There is no evidence in the record that actions by Premera to increase premiums in certain Eastern Washington counties, as theorized by PwC, would be practical, would actually result in higher rates, or would have any impact on Premera's target margins. *See, e.g.,* RP 1875; RP 1961. As demonstrated by its own testimony, the PwC concern about rates is speculative.

The expert economists testifying on behalf of both the OIC Staff and Premera agreed that Premera could not increase premiums above competitive levels.[29] The PwC witnesses testified that there is no predictive value in their rate model, and they acknowledged that any prediction of rate increases was speculative. RP 1730; RP 1875. Accordingly, the Commissioner's conclusion that premiums for individual and small group products "will likely increase" in certain Eastern Washington counties is not supported by the evidence and does not provide a basis for disapproval of Premera's Amended Form A Statement.

[29] RP 1780-81; Ex. S-17, p. 44; RP 525-31; Ex. P-22, pp. ES-3 – ES-4.

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The Commissioner's conclusion that Premera will likely increase premiums also depends on his finding that Premera has market power—that is, the ability to raise and keep premiums above competitive levels. The Commissioner bases that finding upon the testimony of the OIC Staff's economic expert, Keith Leffler.[30] Dr. Leffler's definition of the relevant market (individual counties in Eastern Washington) (Finding 69) is grounded in an erroneous application of the law, for he failed to account for "supply substitution."

In defining a relevant economic market, the law requires a consideration of both demand substitution and supply substitution principles. *Rebel Oil Co. v. Atlantic Richfield Co.* 51 F.3d 1421, 1436 (9th Cir.), *cert. denied,* 516 U.S. 987 (1995); *Virtual Maintenance, Inc. v. Prime Computer, Inc.,* 11 F.3d 660, 664 (6th Cir. 1993), *cert. denied*, 512 U.S. 1216 (1994).[31] Had supply substitution been properly considered, as it was by Premera's economic consultant (RP 518-24; Ex. P-22, pp. 12-18), the Commissioner's findings would have reflected a broader market, and as a result, he would have found lower market shares for Premera, thus ending the inquiry as to whether Premera has market power.[32]

Even if high market shares existed, which is not a finding supported by law or by substantial evidence, further analysis of the existence of barriers to entry and expansion by rivals would be warranted to determine whether Premera has market power. *See* Finding 72. The Commissioner's finding that high barriers to entry and expansion exist (Finding 74) is not supported by substantial evidence. The Commissioner's finding that switching

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[30] The Commissioner finds that the PricewaterhouseCoopers' economic impact consultants also concluded that Premera has market power (Finding 77), but they only assumed such market power based on the work by Dr. Leffler. RP 1957, 1969-76.

[31] This means that a relevant market must consist of all actual and potential competitors that can serve as a check on a company's ability to increase its prices, or premiums, above competitive levels. From a demand perspective, that would include all actual competitors that are presently competing with products that would be viewed by consumers as demand substitutes. From a supply perspective, that would include all potential competitors that could allocate existing resources, enter the market, and begin competing against the firm in question if it raised its prices. *See Rebel Oil*, 51 F.3d at 1436 (citing Phillip Areeda & Donald F. Turner, Antitrust Law ¶ 521a, at 354 (1978)).

[32] Such shares would have been below 60%, which the Commissioner correctly found to be a threshold below which no further analysis of market power is required. Finding 72.

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costs and exclusive rights to the Blue Cross and Blue Shield marks result in high entry barriers in Eastern Washington is based on the testimony of Dr. Leffler, a witness he determined to be credible. Findings 68, 74. The Commissioner's findings ignore Dr. Leffler's testimony on cross-examination. Dr. Leffler readily admitted that the recent successful entry and growth by Asuris in Spokane County without the use of the Blue mark undermined his prior opinion that high barriers to entry and expansion exist and that, as a result of that information, it would be his opinion that Premera has an effective competitor that will constrain it from increasing premiums above competitive levels. RP 1788, 1790-93. This evidence is consistent with other evidence of low barriers to entry and expansion in Washington. RP 524-26; Ex. P-22, pp. 21-26.

The Commissioner's finding that Premera can exercise market power is further contradicted by the testimony and report submitted by Dr. Leffler. Dr. Leffler ultimately determined that, even if Premera had market power, such power is constrained by OIC rate setting regulations. RP 1780-81; Ex. S-17, at 44; *accord* RP 1782 (no evidence of supra-competitive premiums or profits). In other words, Dr. Leffler found that Premera did not have any ability to increase premiums for its individual and small group lines above competitive levels.

2. Medical Loss Ratio

The Commissioner makes four findings pertaining to provider reimbursements and medical loss ratios ("MLRs"). First, he goes through Dr. Leffler's analysis of whether Premera has market power with respect to purchasing provider services. Dr. Leffler finds that Premera has market power in 14 Eastern Washington counties but concludes that such power has already been exercised. Finding 76. As Dr. Leffler testified, this means that Premera lacks the ability to reduce provider payments further. RP 1781-82. Second, the Commissioner refers to non-peer reviewed studies described in a report prepared for the Intervenors. Those studies report that nonprofit health plans in California and Missouri

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spend larger portions of premium revenue on health care than for-profit plans do. Finding 86. Third, he finds that the risk in this case of decreased spending on medical care is unacceptable. Finding 87. Fourth, he finds that a decrease in medical expenditures "is the likely consequence of Premera having to reduce costs to meet investor expectations." Finding 176. These findings are contradictory: Dr. Leffler's analysis, which the Commissioner finds credible, fatally undermines Findings 87 and 176. Any suggestion that Premera's provider reimbursements will drop as a result of the conversion is not supported by substantial evidence.[33]

With respect to the MLR data referred to in Finding 86, the undisputed evidence shows that one cannot meaningfully compare MLRs between companies. Different companies have different mixes of lines of business, which can produce different MLRs. Ex. P-28, p. 9. No witness studied Premera's mix of business and determined that the conclusions drawn from the studies referenced in the Intervenors' report (or any other report) can be applied to Premera. No witness studied Premera's MLR or its spending on medical care and concluded that either one will decrease as a result of the conversion. On the contrary, unrebutted evidence established that Premera's MLR is projected to remain stable and that it will not decrease, regardless of whether Premera converts. Ex. C-2 (Amended Form A Statement), Exhibit E-7, pp. 47-48.

The Commissioner's findings do not and cannot support his conclusion that Premera's spending on medical costs as a percentage of its premium revenue (that is, its MLR) will likely decrease as a result of conversion. Conclusions 9, 10. Furthermore, even if there were a basis in the evidence to draw such a conclusion, it would not follow (as the Commissioner asserts) that a diminished MLR is unfair and unreasonable to subscribers and not in the public interest. Savings in medical costs could result, for

[33] Dr. McCarthy testified that Premera lacks market power over provider reimbursements. The testimony of the expert economists, therefore, establishes not just the unlikelihood but the impossibility that conversion will result in lower provider reimbursements.

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example, from negotiating better drug prices. Even reducing reimbursements to providers is not harmful to subscribers, unless their access to provider networks would suffer as a result. The Holding Company Acts direct the Commissioner to look after policyholder interests, not to boost physician and other provider compensation. The Commissioner makes no finding of reduced access in this case.

3. Economic Assurances

The Commissioner finds that the economic assurances provided by Premera would be "mostly ineffective" to constrain Premera from increasing individual and small group premiums in Eastern Washington above competitive levels following the conversion. Finding 84. These assurances were requested by the OIC Staff's consultants. There is no substantial evidence that they would be ineffective, even if they were necessary.

Undisputed evidence established that the economic assurances are designed to constrain Premera from raising premium rates in Eastern Washington in excess of those in Western Washington (which everyone agrees is competitive). Among other things, the assurances require Premera to (1) continue its current practice of utilizing benefit relativity factors that do no distinguish between Eastern and Western Washington in the development of premium rates for individual and small group products, (2) not change the sources of data and areas definitions used to develop geographic area factors for small group products or use geographic factors for individual products, and (3) maintain a network for a statewide PPO product. Ex. C-2 (Amended Form A Statement), Exhibit E-8. The OIC Staff's economic impact experts testified that the economic assurances mitigate any concerns about Premera's ability to raise premiums during the period that the assurances are in effect. RP 1733; RP 1915; *see also* RP 1808, 1811. No witness testified that Premera has the ability to increase premiums in Eastern Washington above competitive levels, or that the assurances are otherwise ineffective, during the period in which they remain in effect.

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E. The Commissioner has made findings that are not supported by substantial evidence and drawn conclusions that are not supported by the findings.

In addition to the missing findings and unsupported findings and conclusions discussed above, the Final Order contains many assertions for which there is no support. More generally, the Final Order is not supported by evidence that is substantial in light of the whole record. By way of example only, Premera notes the following:

1. Taxes.

Conclusion 11 states that the "likelihood of increase in premiums and decrease in medical loss ratio . . . is exacerbated by the likely loss of the Section 833(b) special tax deduction . . . ." This conclusion has two fundamental flaws: first, there is no evidence that conversion is likely to result in the loss of the Section 833(b) deduction; and second, there is no basis to say that potential changes in taxes will cause premiums to increase or the medical cost ratio to fall, much less that they affect the likelihood of such alleged consequences.

The only evidence in the record regarding whether the conversion would be more or less likely to result in the loss of the Section 833(b) deduction is the testimony of Richard Ashley, an OIC Staff consultant. Mr. Ashley stated that Ernst & Young had determined, in a draft short-form opinion, that Premera would more likely than not *retain* the deduction. RP 1534-35. Mr. Ashley did not express a view to the contrary. He testified, rather, that there remains "a considerable degree of risk" and that the conversion "may" be treated as a material change in Premera's structure. RP 1535, 1533.[34] In view of this risk, PwC suggested to the other advisors that they assume the loss of tax benefits, "to look at it on kind of a worst case basis." RP 1546. This they did. Contrary to the

[34] Mr. Ashley also testified that Premera "has some substantial arguments to support a position that the 833(b) deduction should be maintained and the company will not experience a material change, but I believe there is a significant risk that they may not prevail on that issue." RP 1539. There is no authority that illuminates the question. Mr. Ashley acknowledged that the IRS's informal expression of its view, cited in Finding 154, has no force of law.

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implication in Finding 154, PwC never advised the Commissioner "to assume that the transaction would constitute a 'material change.'"

If the risk of losing Section 833(b) benefits were realized, Mr. Ashley testified, he would be concerned about the potential "diminution in the value of the enterprise." RP 1537. Neither he nor any other witness testified that there would be harm to Premera's subscribers or to the insurance-buying public as a result. On the contrary, the PwC reports reflect that Premera, in response to an inquiry whether subscribers would be affected by any adverse tax impact, indicated "that any additional cost would not be passed on to policyholders." Ex. S-12, p. 12. The OIC Staff recommended a condition to this effect, and Premera advised the Commissioner that it would accept such a condition. There is no factual basis, therefore, for Finding 155 or Conclusion 11.

Conclusion 11 also refers to an "increase in Alaska premium tax." This refers to the fact that, after conversion, Premera Blue Cross Blue Shield of Alaska will join its for-profit competitors in paying premium taxes of 2.7% rather than 2.0% to the State of Alaska. Those taxes, however, relate solely to Alaska policyholders, and they will be paid by a different legal entity than the one that, after the conversion, will be offering health care coverage to Washington subscribers. Whether increased premium taxes might be passed through to Alaska policyholders by a company operating solely in Alaska is an issue for the Director of the ADI.[35] In purporting to rule on this issue, the Commissioner again acts outside his agency's jurisdiction and authority. The undisputed evidence shows that this issue has nothing whatever to do with the interests of subscribers or the insurance-buying public in Washington. *See* Ex. P-46, pp. 2-6. In suggesting otherwise, Conclusion 11 is erroneous.

[35] The Director addresses this issue through a condition relating to the duration of Premera's rate assurances. *See* http://www.dced.state.ak.us/insurance/orders/R03-07.pdf, pp. 23-26 & 67. The Commissioner, by contrast, cites the increase in Alaska premium tax as a basis to condemn the Amended Form A Statement.

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2. Expenses

Conclusion 11 also refers to "increased annual expenses of operating as a public company." Such expenses, estimated at $3.5 million, are immaterial according to the undisputed evidence of the OIC Staff's investment banking consultant. They represent approximately 1/10 of 1% of Premera's annual revenues. There is no evidence to suggest that such expenses would increase premiums, decrease Premera's MLR, or make either of those outcomes more likely. To focus upon this single expense item and ignore the savings in per-subscriber administrative expenses made possible by having greater capital, which would permit Premera to grow its customer base and to invest in technological and other cost-saving innovations, is not just myopic. It shows that the Final Order is not supported by evidence that is substantial when viewed in light of the record as a whole.[36]

3. Compensation

Conclusion 11 refers, finally, to a "tendency for above market compensation packages." On its face, this conclusion reflects speculation: a supposed "tendency" is not a determination of a likely outcome. Nor is there anything in the record, other than speculation, to support a conclusion that Premera's post-conversion executive compensation packages would be above market.

The Commissioner's findings regarding executive compensation, Findings 157 through 172, do not support Conclusion 11. Furthermore, many of those findings themselves contain statements that are unsupported by the evidence. For example, Finding 170 states that the base salaries of Premera's executives previously increased at a rate that was higher than the market, but the same finding recognizes that their current level is comparable to the market. Finding 170 then goes on to observe that the OIC

[36] Incurring these expenses is inherent in operating as a public company. Conclusion 11 therefore suggests that the Holding Company Acts, which the Commissioner has stated are intended to guide the evaluation of proposed conversions, preclude any conversion. Indeed, Conclusion 11 suggests that the Holding Company Acts forbid any public company from acquiring a non-public Washington insurer. Both suggestions are absurd.

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Staff's executive compensation expert, PwC, found that "because the rest of the executive compensation plans are calculated on the base salary, *if* the past rate of increase continued, executive compensation would come to greatly exceed the market." (Emphasis added.) This finding is speculative: there is no evidence that the past rate of increase will continue.[37]

In addition to being speculative, the last sentence of Finding 170 is undermined by the testimony of the PwC executive compensation expert, Mr. Nemerov, whose report and testimony the Commissioner found to be credible. Mr. Nemerov testified that the current base salaries of Premera's executives are in the range of market competitiveness. RP 1619. Similarly, he testified that the benefits of the executives were at market. RP 1600; RP 1612. He admitted that, while there had been increases in executive compensation in the past several years, those increases were merely efforts by Premera's Board to get its executives, whose compensation had been below the median, up to the median. RP 1615.[38] Mr. Nemerov said that it would be speculation for anyone to conclude that the executives' compensation would go above the median in the future. RP 1615-16. Yet the

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[37] The Commissioner's other findings regarding executive compensation are also not supported by substantial evidence. Many relate to historical information regarding Premera's executive compensation, which is not relevant to the conversion and to future levels of compensation. Most of PwC's concerns about this historical information are due to PwC's misunderstanding of the actual job responsibilities of some of Premera's executives and of the actual operation of Premera's annual and long term incentive plans. Those misunderstandings, in turn, were due to the fact that PwC's expert never talked to any of the executives or any of the members of the Compensation Committee but instead relied upon job titles and his reading of the plan documents. *See* RP 1617, 1624; Ex. P-52. Many concerns about compensation benefits raised in the findings are not supported by substantial evidence; rather, the evidence in the record is to the contrary. *See* Ex. P-52; Ex. P-53 at 5-7.

[38] That the previous increases in compensation were based on the need to bring the executives up to the median level, and that such past increases do not demonstrate any tendency to increase above market in the future, was corroborated by the written reports and testimony of Premera's executive compensation expert and by the testimony of two members of Premera's Board of Directors. *See* Ex. P-49, at 9-12; Ex. P-51 at 10-12; Ex. P-53 at 3; RP 756 (Furniss); Ex. P-2 at 4; RP 80-81 (Board Member Sally Jewell); Ex. P-48; RP 1086, 1095-99 (Board Member Patrick Fahey).

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Commissioner engaged in precisely such speculation in entering Conclusion 11 about a "tendency for above market compensation packages."

Beyond these fundamental problems with the "tendency" portion of Conclusion 11, the asserted "exacerbation" regarding alleged increases in premiums and decreases in medical loss ratio is also pure speculation.[39] There is no evidence whatever that Premera's post-conversion compensation packages would proximately cause an increase in Premera's premiums or a decrease in its medical loss ratio, or exacerbate the likelihood of such consequences. Thus, the Commissioner's statement regarding executive compensation in Conclusion 11 is erroneous.

F. The Commissioner has misinterpreted the Holding Company Acts.

According to the Commissioner, "the substantive and procedural requirements of Chapters 48.31B and 48.31C are essentially the same." Final Order at 6 n.6. In reality, the language of the two statutes is substantially different. The Commissioner also concludes that "[t]he antitrust inquiry in RCW 48.31C.030(5)(a)(ii)(B) [sic] . . . is independent of other bases of disapproval set forth in RCW 48.31C.030(5)(a)(ii)(C) . . . ." Conclusion 4. To suggest otherwise, he says, "makes no sense." *Id.* On the contrary, the Legislature must be assumed to have acted deliberately in crafting the standards in the Holding Company Acts. The Commissioner erred in failing to consider the statutory language and in failing to make findings on the critical threshold issues presented by that language.

Both Holding Company Acts state that the Commissioner "shall approve" a Form A statement "unless, after a public hearing," he or she makes an adverse finding on specified criteria. RCW 48.31B.015(4)(a); RCW 48.31C.030(5)(a). Those criteria are not, however, the same in the two statutes. The Health Care Service Contractors Act

[39] Conclusion 11 states in part that "[t]he likelihood of increase in premiums and decrease in medical loss ratio, as a consequence of Premera converting to a for-profit company, is exacerbated by the . . . tendency for above market compensation packages . . . ."

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specifically prohibits disapproval unless the Commissioner makes a finding that (1) New PREMERA will not be able to satisfy the requirements for registration as a health carrier or (2) the conversion will have an anticompetitive impact on the market for health coverage. In this case, there is no basis to make either finding.

First, there is no dispute that Premera satisfies all applicable requirements for registration as a health carrier. *See* Ex. S-31, p. 28 n.63; *id.* at 14 ("PREMERA seems to have satisfied this requirement [of being able to satisfy a domestic health carrier's registration requirements]."); Ex. S-33 (Exec. Summ.), p. 9. Second, there is no evidence, much less substantial evidence, that the conversion will have an anticompetitive effect. Dr. Leffler, whom the Commissioner found credible, states: "The conversion does not directly affect in any way the number of competitors offering health insurance in Washington, and it, therefore does not directly impact competition." Ex. S-17, p. 2; *see also id.* at 4-5 (the "proposed conversion does not appear to raise significant antitrust issues."); Ex. P-20, p. 1.

The two Holding Company Acts address antitrust issues in very different ways. The Insurer Act requires that the Commissioner's antitrust determination be guided by (1) informational requirements, (2) mandatory approval for otherwise anticompetitive acquisitions that result in substantial public benefits, and (3) conditional approval for acquisitions that are anticompetitive but can be structured to be competitive or to provide substantial public benefits to justify the anticompetitive effects. *See* RCW 48.31B.015(4)(a)(ii). Subsections 4(a)(iii) - (vi) in the Insurer Act establish four stand-alone bases for rejecting an acquisition under the Insurer Act, wholly apart from the antitrust standard in subsection 4(a)(ii):

> The commissioner shall approve a merger or other acquisition of control referred to in subsection (1) of this section unless, after a public hearing thereon, he or she finds that:
> ***
> (iii) The financial condition of an acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the

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interest of its policyholders;

(iv) The plans or proposals that the acquiring party has to liquidate the insurer, sell its assets, consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest;

(v) The competence, experience, and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or

(vi) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

RCW 48.31B.015(4)(a)(iii) - (vi).[40]

In the Health Care Service Contractors Act, by contrast, the Washington Legislature rejected the use of such factors as standalone grounds for disapproval, instead subsuming them in the Commissioner's antitrust determination. The Legislature drafted the antitrust determination section of the Health Care Service Contractors Act to encompass the same three guidelines as in the Insurer Act. The Legislature, however, completely altered the third guideline, dealing with conditional approval of anticompetitive acquisitions: It listed under that guideline the four criteria that, in the Insurer Act, constitute independent grounds for evaluating a Form A. The Health Care Service Contractors Act provides as follows:

As to the commissioner, in making this determination:

***

(C) The commissioner may condition the approval of the acquisition on the removal of the basis of disapproval, **as follows**, within a specified period of time:

(I) The financial condition of an acquiring party is such as might jeopardize the financial stability of the health carrier, or prejudice the interest of its subscribers;

(II) The plans or proposals that the acquiring party has to

[40] The Commissioner makes no adverse findings on any of these criteria with respect to the two Premera companies that are subject to the Insurer Act: LifeWise Assurance Company and LifeWise Health Plan of Arizona, Inc. Both are already for-profit entities.

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> liquidate the health carrier, sell its assets, consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to subscribers of the health carrier and not in the public interest;
>
> (III) The competence, experience, and integrity of those persons who would control the operation of the health carrier are such that it would not be in the interest of subscribers of the health carrier and of the public to permit the merger or other acquisition of control; or
>
> (IV) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

RCW 48.31C.030(5)(a)(ii)(C) (emphasis added).

The Legislature's use of the phrase "as follows" signals the Legislature's intent to specify factors (I) – (IV) as bases for conditional approval of an otherwise anticompetitive acquisition. Under the Health Care Service Contractors Act, such factors cannot serve as standalone grounds for disapproval. Rather, they must be interpreted in light of the larger antitrust subsection in which they are found. *See In re Detention of Williams,* 147 Wn.2d 476, 490, 55 P.3d 597 (2002) ("[i]n order to interpret a statute, each of its provisions 'should be read in relation to the other provisions, and the statute should be construed as a whole.'").

The Legislature is presumed to have acted intentionally in drafting the statute. *See State v. McKinley,* 84 Wn. App. 677, 686, 929 P.2d 1145 (1997) ("[b]ecause the Legislature is presumed not to pass meaningless legislation, when it enacts an amendment to a statute, a presumption exists that a change was intended."); *see also State v. Moses*, 145 Wn.2d 370, 374, 37 P.3d 1216 (2002) ("Where the Legislature omits language from a statute, intentionally or inadvertently, this court will not read into the statute the language that it believes was omitted.").

The Commissioner treats the language in the Health Care Service Contractors Act as a mistake. Under Washington law, perceived legislative error may be corrected only in the rare instance that an omission or mistake makes the statute *entirely meaningless*. The

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Washington Supreme Court "has exhibited a long history of restraint in compensating for legislative omissions." *State v. Delgado*, 148 Wn.2d 723, 730, 63 P.3d 792 (2003). Contrary to the Commissioner's conclusion, applying the tests in the Health Care Service Contractors Act as the Legislature directed would not render the statute "entirely meaningless."

Subsection 5(a)(ii) provides one basis for Commissioner disapproval: substantial evidence of anticompetitive effect in the health insurance market. It begins: "[t]he commissioner shall approve an acquisition of control . . . unless . . . he or she finds that . . . there is substantial evidence that the effect of the acquisition may substantially lessen competition or tend to create a monopoly in the health coverage business." All the subparts that follow are an elaboration of this basic statement. "[I]n making this determination . . . [t]he commissioner may not disapprove the acquisition if the commissioner finds that" the acquisition creates certain benefits which outweigh the benefits from increased competition. RCW 48.41C.030(5)(a)(ii)(B). The Health Care Service Contractors Act identifies these compensating benefits as "substantial economies of scale or economies in resource use that cannot be feasibly achieved in any other way" and the substantial increase or prevention of "significant deterioration in the availability of health care coverage." RCW 48.31C.030(5)(a)(ii)(B)(I) & (II). Thus, read as a whole, subsection 5(a)(ii) allows the Commissioner to disapprove the conversion only if it creates anticompetitive effects without any compensating economies of scale or increased availability of health care coverage.

Read in context—that is, as part of subsection 5(a)(ii)—subpart C allows the Commissioner to remedy the basis for disapproval, namely the lack of any compensating economies of scale or increase in availability of health care coverage, by conditioning his approval upon the removal of factors that prevent the realization of those compensating benefits. The factors enumerated in subpart C may well underlie a failure to produce such

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compensating benefits. Poor financial condition of the resulting entity, "unfair and unreasonable" changes to the business, unqualified directors and officers, and acquisition features that are "hazardous or prejudicial to the insurance-buying public" are all factors that undercut an acquisition's capacity for creating economies of scale or an increase in the availability of health care coverage in the State.

By contrast, where there is no finding of anticompetitive effect, subsection 5(a)(ii) mandates that "[t]he commissioner shall approve" the acquisition, and the factors enumerated in subpart C simply do not apply. *See City of Kent v. Beigh*, 145 Wn.2d 33, 45, 32 P.3d 258, 264 (2001) ("[I]t is an 'elementary rule that where the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent.'").[41] Because Premera's Amended Form A Statement involves no anticompetitive effects, the Commissioner erred in relying upon the factors set forth in subpart C of RCW 48.31C.030(5)(a)(ii) as a basis to disapprove the proposal.

G. The Final Order is arbitrary and capricious.

A pattern emerges when one compares the Final Order with the evidence in the record, considered as a whole. Undisputed evidence of the benefits of Premera's proposal to its subscribers and to the insurance-buying public has been ignored or distorted. Consequences that multiple witnesses agreed are likely or certain have been termed "speculative." In the case of the foundations that Premera proposes to create, there is not one word about their potential benefits, but rather a welter of findings based upon the false premise that Premera owes "fair market value," which somehow means something

[41] The Commissioner's speculation that applying the Health Care Service Contractors Act as written would require him to approve a Form A statement if the financial condition of the company was in jeopardy or the management was incompetent or inexperienced (Conclusion 4) ignores the requirement in RCW 48.31C.030(5)(a)(i) that the company must be able to satisfy the requirements for registration as a health carrier. *See* Finding 103.

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different from the $500-700 million that these foundations will realize if, but only if, the conversion proceeds.

Conversely, the Final Order overstates the evidence concerning potential criticisms of or concerns about the proposed conversion. The admissions upon cross-examination of witnesses whom the Commissioner found credible have been ignored. Consequences that, according to the evidence, are speculative at best have been termed "likely" or even certain.

In all these respects, and many others, the Final Order betrays a treatment of Premera's application that is wholly at odds with reasoned decision making in an adjudicative proceeding. The Final Order flouts the language in Judge Casey's Order. It is willful; it has been entered in disregard of the evidence and in violation of the law. It is, in short, arbitrary and capricious.

H. Summary

Upon review of the record, the Court should set aside the Final Order and grant the relief requested in Part VIII below because the Final Order and its findings and conclusions are (a) contrary to Judge Casey's Order; (b) contrary to the proper application of the criteria in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a); (c) outside the agency's statutory authority or jurisdiction; (d) erroneous interpretations and applications of the law; (e) not supported by evidence that is substantial when viewed in light of the whole record; (f) incomplete; and/or (g) arbitrary and capricious.[42]

VIII. Request for Relief

Pursuant to RCW 34.05.574, Premera requests all relief available to it in this proceeding, including but not limited to the following:

[42] In addition to failing to decide all of the issues requiring resolution by the agency in this matter, the Commissioner erred in making Findings 9-10, 12-13, 17, 19, 23-28, 30-31, 33-34, 36-41, 44-79, 81-155, 157-178, and B1-B7, in whole or in part, as well as in reaching Conclusions 2 through 17.

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A. That the Final Order be set aside;

B. That the Court make findings and conclusions identifying each violation or error in the Final Order, including the following:

1. The Commissioner is bound by the law as established in Judge Casey's Order, and the Final Order violates the law of the case doctrine;

2. The Commissioner must base his decision upon the criteria set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a) as written, and the Final Order misinterprets those criteria and improperly applies different and additional tests to Premera's Amended Form A Statement;

3. The Commissioner erred in purporting to exercise jurisdiction under, and in basing the Final Order in part upon, the Washington corporation statutes (Title 23B and chapters 24.03 and 24.06 RCW) and/or the Acquisition of Nonprofit Hospitals Act (chapter 70.45 RCW);

4. The Commissioner erred in interpreting the Holding Company Acts, the Washington Nonprofit Corporation Act(s), the Acquisition of Nonprofit Hospitals Act, the Amended Form A Statement, Premera's articles of incorporation, and other purported sources to require Premera to transfer the "fair market value" of its assets to the Washington and Alaska foundations;

5. The Commissioner erred in failing to make findings on matters germane to the criteria in the Holding Company Acts, including but not limited to the public benefits of the proposed Washington Foundation, and in failing to consider and weigh those benefits in

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making findings and conclusions regarding the consequences of the conversion;

6. The Commissioner erred in basing his findings regarding the economic consequences of the conversion upon speculation and errors of law;

7. The Commissioner erred in failing to consider supply substitutes in defining the relevant market;

8. The Final Order, including its constituent findings and conclusions, is not supported by evidence that is substantial when viewed in light of the whole record before the Court; and

9. The Final Order is arbitrary and capricious;

C. That the Court enter an order declaring (1) Premera's Amended Form A Statement meets the criteria for approval set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a); (2) the Amended Form A Statement should therefore be approved; and (3) the matter is remanded to the Commissioner with direction that the Commissioner enter an order consistent therewith;

D. If the Court does not grant the relief requested in Paragraph C, that the matter be remanded to the agency, i.e., the Office of the Insurance Commissioner of the State of Washington, for further proceedings consistent with the findings and conclusions described in Paragraph B, and that the agency be instructed as follows with respect to its review of the record on remand:

1. The agency must apply the criteria set forth in RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a), as written, to Premera's Amended Form A Statement;

2. The agency must make findings on all relevant criteria and associated issues (e.g., the "public interest" as that phrase is used in

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RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a)—namely, as a potential counterbalance to perceived subscriber harm);

3. The agency may not apply criteria to Premera's Amended Form A Statement based upon sources other than RCW 48.31B.015(4)(a) and RCW 48.31C.030(5)(a);

4. The agency may not make findings or conclusions that are contrary to law or that address matters beyond the scope of its jurisdiction and authority, such as findings or conclusions regarding "fair market value";

5. The agency may not make any findings or conclusions based upon speculative harms;

6. The agency must make findings and conclusions reflecting the evidence of benefits of Premera's conversion proposal, including the substantial benefits to Premera's subscribers and the insurance-buying public of Premera's having more capital and greater access to capital, as well as the substantial benefits of the proposed Washington Foundation in addressing the unmet health needs of Washington residents;

7. The agency must make findings and conclusions reflecting the absence of evidence in the record that Premera's conversion would result in increased premiums, diminished provider reimbursements, or a decreased medical loss ratio;

8. The agency must make findings and conclusions reflecting the evidence that the possible loss of Premera's Section 833(b) tax deduction, the increase in the Alaska premium tax, the increase in Premera's annual expenses due to operating as a public company,

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and/or any tendency for above market compensation packages, either singly or together, do not demonstrate that Premera's plan for conversion is unfair and unreasonable to subscribers or likely to be hazardous or prejudicial to the insurance-buying public, or otherwise constitute a basis for rejecting Premera's conversion; and

9. The agency must make findings and conclusions that, considering Premera's conversion plan as a whole, there is no evidence in the record that constitutes a basis for rejecting Premera's Amended Form A Statement; and

E. That Premera be granted all other just and equitable relief.

DATED this 13th day of August, 2004.

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Exhibit A

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates	Docket No. G02-45 FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL ORDER

I. PROCEDURAL HISTORY

This matter comes before Mike Kreidler, the Insurance Commissioner for the State of Washington (the "Commissioner") on the application of PREMERA and Premera Blue Cross, and their affiliated companies, (collectively, "Premera"), filed with the Office of the Insurance Commissioner ("OIC"), seeking the approval of the Commissioner for the reorganization of Premera that will result in a change of control of the holding company system and the conversion of the nonprofit affiliates to for-profit companies. The issuance of these Findings of Fact, Conclusions of Law, and Final Order (the "Final Order") is the product of an extensive review of Premera's application for reorganization, which is comprised of a Form A and Form D filings (collectively referred to as the "Application" or the "Form A"). The review process culminated in a public adjudicative hearing conducted pursuant to the

Administrative Procedure Act, Chapter 34.05 RCW, which was held from May 3, 2004, to May 19, 2004, in Tumwater, Washington.[1]

I presided over the hearing and, as the final decision maker, am issuing this Final Order. At the hearing evidence was offered by Premera, the OIC Staff Review Team, and the Interveners. All parties were represented by counsel.[2] Forty-one witnesses presented live testimony and 290 exhibits were admitted into the record. Included among the exhibits are 27 expert reports that provide analyses of the proposed transaction.

Prior to the formal adjudicative hearing I held two rounds of public hearings in various locations around the state. The first round was held after the filing of the Form A but prior to the issuance of any expert reports in September and October of 2002 with hearing sites in Seattle, Spokane, Richland, and Vancouver. The second round was held after the issuance of the experts' initial reports in December 2003 with hearing sites in Spokane, Yakima, SeaTac, and Bellingham. Testimony was taken under oath from the public during the second round of hearings, and both sets of hearings were recorded and transcribed. Written public comment was also accepted through May 21, 2004, with 5,815 communications in the form of postcards, e-mails, letters, and phone calls being received.

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[1] George Finkle, who was appointed Special Master in this matter and is a retired King County Superior Court judge, conducted the hearing.

[2] The OIC Staff Review Team (the "Staff" or "Review Team") is led by James T. Odiorne, Deputy Insurance Commissioner for Company Supervision. The Staff's lead counsel from the Washington Attorney General's Office is Assistant Attorney General Melanie deLeon and Special Assistant Attorney General John Hamje. Premera is represented by the law firm of Preston, Gates, & Ellis LLP, with Thomas Kelly and Robert Mitchell as lead counsel. The Intervener groups are represented as follows. The Premera Watch Coalition is represented by Eleanor Hamburger of Columbia Legal Services. The Washington State Hospital Association and Association of Washington Public Health Districts are represented by Michael Madden of Bennet, Bigelow & Leedom, P.S. The Washington State Medical Association is represented by Jeffrey Coopersmith of the Coopersmith Law Group. Finally, the Alaska interveners are represented by Amy McCullough of the Alaska Legal Services Corporation and Ardith Lynch on behalf of the University of Alaska.

Premera formally notified me and the Attorney General of its intention to reorganize and convert from a nonprofit company to a for-profit company in letters dated May 30, 2002. S-71; S-96.[3] Premera acknowledged in the letters that the Insurance Commissioner has jurisdiction over the transaction under the Insurance Code, in particular the Holding Company Acts, Chapters 48.31B and 48.31C RCW. Premera further acknowledged the Attorney General's authority to review certain aspects of the transaction regarding the dissolution of the nonprofit corporations and transfer of assets under the Nonprofit Corporation Act, Chapters 24.03 and 24.06 RCW. The respective roles of the Insurance Commissioner and the Attorney General are outlined in a memorandum dated October 15, 2002, to the Attorney General from her staff, which she shared with me and was made public prior to the commencement of these proceedings. I-2. In addition, in a letter dated November 19, 2002, the Attorney General informed me that the Attorney General's Office ("AGO") would not initiate a separate and independent antitrust review of the transaction but that the AGO would act in a consultative role with the OIC Staff. C-14.

On September 17, 2002, Premera filed its initial Form A concurrently with the Office of the Insurance Commissioner and the Office of the Attorney General seeking our respective approvals of the proposed reorganization, conversion to for-profit, and dissolution and distribution of all the assets of the Premera nonprofit companies. C-1. On October 24, 2002, I issued a Case Management Order establishing the general procedures for the adjudicative hearing process and a separation of functions for personnel within the OIC so that there would

[3] References to hearing exhibits carry a prefix designating the party followed by the number of the exhibit, such as "P-1" for a Premera exhibit, "S-1" for a Staff exhibit, "I-1" for an Intervener exhibit, and "C-1" for an exhibit adopted into the record by the Commissioner. Not all originally proposed exhibits were offered, and some exhibit numbers were reserved but not used. As result, the numbers of the exhibits admitted into the record do not in all cases follow one after the other. References to the transcript of the hearing will be cited as "TR" followed by the page number.

no *ex parte* communications with me regarding the merits of the Application.[4] In addition, I set a deadline of November 26, 2002, by which any person intending to seek intervener status pursuant to RCW 48.31B.015(4) and 48.31C.030(4) had to file a motion to intervene.[5]

Pursuant to the authority granted under the Holding Company Act, RCW 48.31B.015(4)(c) and 48.31C.030(5)(b), the OIC Staff retained consultants to review Premera's Application. Premera and the Interveners also engaged experts to evaluate the Form A. The Staff and their consultants initiated their review in October 2002. Over the course of their review, they examined over 40,000 pages of documents and conducted numerous interviews of Premera's management and key employees.

As early as February 2003, the OIC informed Premera that there were significant substantive problems with the proposed reorganization and gave Premera the opportunity to address those concerns and revise the transaction prior to the consultants issuing their reports. Included among the concerns was the absence of the detailed stock ownership plan that Premera intended to implement if the conversion were approved. Premera declined to revise its Form A and represented that it would wait to address any problems until after the issuance of the experts' reports.

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[4] The Form A, filings of the parties, expert reports, transcripts, and orders are posted on the website of the Office of the Insurance Commissioner at www.insurance.wa.gov.

[5] I issued an order on February 10, 2003, permitting intervention of numerous organizations and forming them into four intervener groups, as follows: (1) **Premera Watch Coalition,** which consists of Washington Citizen Action, Welfare Rights Organizing Coalition, American Lung Association of Washington, Northwest Federation of Community Organizations, Northwest Health Law Advocates, Service Employees International Union Washington State Council, The Children's Alliance, Washington Academy of Family Physicians, Washington Association of Churches, Washington Protection and Advocacy System, and Washington NOW. The Coalition was also joined by the Washington Association of Community and Migrant Health Centers, which represents 36 health care centers located in 24 Washington counties; (2) **The Hospital Associations,** which consists of the Washington State Hospital Association and the Washington Public Hospital Districts; (3) **The Washington State Medical Association,** which consists of 8,800 members who provide healthcare services to Washington citizens; (4) **The Alaska Interveners**, which includes the University of Alaska, United Way of Anchorage, John Garner (a disabled individual), and Anchorage Neighborhood Health Center. The University of Washington School of Medicine and its components were also granted intervener status but later withdrew their participation.

I requested and received status reports from the parties in February and March, 2003. With the agreement of all the parties, Judge Finkle was appointed Special Master on April 7, 2003. Prior to discovery beginning, Premera requested that a protective order be issued to protect trade secret and proprietary information shared with the parties during these proceedings. A protective order was negotiated among the parties, mediated by the Special Master, and adopted and issued by me on June 13, 2003.

The Special Master recommended a Case Schedule to be triggered upon the production of certain documents by Premera, which I adopted on August 19, 2003. The schedule was triggered on August 26, 2003. However, the Case Schedule was shortened as a result of a stipulation entered on September 12, 2003, in Thurston County Superior Court resolving an administrative appeal by Premera of my Case Management Order. The stipulation recited that I would issue my decision by March 15, 2003. Consequently, the Case Schedule was adjusted accordingly.

Premera was required to file any amendments to the Form A by October 15, 2003. The OIC consultants' final reports were due on October 27, 2003, and Premera's and the Interveners' reports were due on November 10, 2003. The hearing was scheduled for January 15 through 28, 2004. However, the hearing was extended twice at the request of Premera and with the consent of the OIC Staff. The extensions were requested because Premera wanted the opportunity to amend its Form A to address problems raised by the OIC's consultants in their expert reports. Premera filed an amended Form A on February 5, 2004. The parties' consultants subsequently filed supplemental reports on their review of the transaction as amended. The amended Form A, including the stock ownership plan that was ultimately submitted by Premera, is the subject of these proceedings.

II. APPLICABLE LAW

Chapter 48.31B RCW, the Insurer Holding Company Act, and Chapter 48.31C, the Health Carrier Holding Company Act, govern the proposed transaction. (hereinafter collectively referred as "the Holding Company Act").[6] In addition, because the reorganization involves the dissolution of nonprofit corporations and the distribution of their assets, Chapters 24.03 and 24.06 RCW of the Nonprofit Corporations and Associations Act also apply. The Administrative Procedure Act, Chapter 34.05 RCW, has governed the adjudicatory proceedings throughout this case. The most relevant statutory provisions are set forth in Attachment A and are briefly summarized below.

The Holding Company Act regulates, among other things, the acquisition of control of a domestic carrier. RCW 48.31B.015 and 48.31C.030. The acquiring party must submit the transaction to the OIC for review. The commissioner must approve the transaction unless there is a basis for disapproval as set fort the in the statute (also referred to as Form A standards). The bases for disapproval are summarized as follows: (1) After the transaction, the carrier would not be able to satisfy the requirements for the issuance of a license; (2) The effect of the acquisition may substantially lessen competition in this state or tend to create a monopoly (but the commissioner may not disapprove the transaction on this ground if it will yield substantial economies of scale or in resource use not otherwise obtainable, or will substantially increase or prevent significant deterioration in the availability of insurance, and the public benefits that

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[6] Chapter 48.31B governs the acquisition of insurers, other than health care service contractors ("HCSCs") and health maintenance organizations ("HMOs"). Chapter 48.31C. governs the acquisition of control of HCSCs and HMOs. Because the reorganization of Premera's holding company system involves both insurers and HCSCs, both chapters apply. However, the substantive and procedural requirements of Chapters 48.31B and 48.31C are essentially the same. Consequently, for ease of reference and because the focus of the review is on the conversion to for-profit of Premera Blue Cross, a HCSC, this Final Order will primarily refer to Chapter 48.31C RCW.

arise from the economies or availability of insurance exceed the public benefits that would arise from more competition); (3) The financial condition of the acquiring party is such as might jeopardize the financial stability of the domestic carrier, or prejudice the interests of subscribers; (4) Plans for a material change after the acquisition are unfair and unreasonable to its subscribers and not in the public interest; (5) The competence, experience, and integrity of those persons who would control the carrier are such that it would not be in the interests of the entity's subscribers and the public to permit the transaction; or (6) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public. RCW 48.31C.030(5)(a) and 48.31B.015(4)(a).

The Holding Company Act also governs agreements and transactions between companies within an insurance holding company system. The standards for transactions within a holding company system (also referred to as Form D standards) include whether the terms are fair and reasonable. RCW 48.31B.030 and 48.31C.050. Because companies within a holding company system are under common control, review of intercompany transactions by the OIC is an important check to prevent conflicts of interest or financial self-dealing.

Because the reorganization proposed by Premera requires the dissolution of Washington nonprofit corporations and the distribution of their assets, Washington's nonprofit corporation law applies, in particular RCW 24.03.225 and .230, and RCW 24.06.265. The law, as applicable in this case, requires that a nonprofit corporation's assets be distributed in accordance with its articles of incorporation, in accordance with a plan of distribution approved by the Attorney General, or in accordance with a plan of distribution adopted by the corporation.

III. FINDINGS OF FACT

Though the evidence related to some factual issues and the opinions of some experts are conflicting, I have carefully weighed all of the evidence in reaching these Findings of Fact. Even though I specifically refer to certain testimony and documentary evidence to explain my findings, my findings are based on a review of all the evidence and are supported by the preponderance of the evidence. No particular finding is essential to my decision to disapprove Premera's Form A.

A. Summary of the Form A

1. The Form A Statement relates to the acquisition of control of Premera Blue Cross, a Washington nonprofit health care service contractor ("Premera" or "PBC"), Lifewise Assurance Company , a Washington for-profit insurance company ("LWA"), LifeWise Health Plan of Washington, a Washington nonprofit health care service contractor ("LifeWise Washington"), LifeWise Health Plan of Arizona, Inc., a Washington for-profit insurance company ("LW-AZ"), Premera Blue Cross Blue Shield of Alaska Corp., an Alaska for-profit insurance company ("PBC-AK"), and LifeWise HealthPlan of Oregon, Inc., an Oregon for-profit insurance company ("LifeWise Oregon") (collectively referred to as the "Acquired Companies"), all of which are affiliates of the parent company PREMERA, a Washington nonprofit corporation, by a to be formed new entity, New PREMERA Corp., a Washington for-profit corporation. The Alaska Division of Insurance issued a certificate of authority to PBC-AK to operate as a licensed health insurer in that state subject to the consummation of the transactions proposed in Premera's Form A.

2. Premera engages in the health insurance business in Washington and Alaska under the Blue Cross mark. LifeWise Washington operates as a nonprofit in the health

insurance business in those counties in Washington where Premera is precluded from marketing under the Blue mark because the local Blue Shield company, Regence, has the license to use the mark in those counties.

3. The reorganization of the holding company system is proposed to be accomplished through a series of transactions that will occur simultaneously pursuant to which the parent company (PREMERA), Premera Blue Cross, and LifeWise Washington will convert from Washington nonprofit corporations organized under Titles 24.06 and 24.03 RCW, respectively, to Washington for-profit corporations organized under Titles 23B RCW.

4. The Washington Foundation Shareholder ("Washington Foundation"), a Washington nonprofit corporation, and the Alaska Health Foundation ("Alaska Foundation"), an Alaska nonprofit corporation, are to be created and will become members of PREMERA. The end result of the proposed transaction is that the Washington and Alaska Foundations will own 100% of the new parent company (New PREMERA). The steps of the transaction to reach this result are as follows.

5. PBC will transfer certain of its assets and liabilities directly related to its operations in Alaska to its newly formed, wholly owned subsidiary, PBC-AK, in exchange for 100% of the stock of PBC-AK. PBC will then transfer of all of its assets and liabilities, including the stock of PBC-AK, to its other newly formed, wholly owned subsidiary, New PBC, a Washington for-profit corporation, in exchange for 100% of the stock of New PBC. After the foregoing transfer, PBC-AK will become a direct wholly owned subsidiary of New PBC.

6. PBC will then perform a statutory liquidation and distribute the New PBC stock to its parent PREMERA. New PBC will transfer 100% of the stock of PBC-AK to

PREMERA at which point New PBC and PBC-AK are direct wholly owned subsidiaries of PREMERA. PREMERA will then transfer all of its assets and liabilities to its newly formed wholly owned for-profit subsidiary, New PREMERA, in exchange for 100% of the stock of New PREMERA. PREMERA will then perform a statutory liquidation and distribute the New PREMERA stock to its sole members, the Washington and Alaska Foundations.

7. After the completion of the proposed transaction, the Washington and Alaska Foundations collectively will own 100% of the capital stock of New PREMERA, and New PREMERA will directly or indirectly control the Acquired Companies. However, the Foundations will disclaim control of the Acquired Companies within the meaning of RCW 48.31B.005(2) and 48.31C.010(3).

8. In connection with the proposed transaction, PREMERA, PBC, and LifeWise Washington will seek a solicitation permit from the Office of the Insurance Commissioner in accordance with RCW 48.06.040.

9. Because the proposed transaction involves regulated insurance entities in Washington, Alaska, and Oregon, PREMERA sought approval from the insurance commissioners in all three states as to one or more parts of the transaction. In addition, because the reorganization involves the dissolution of Washington nonprofit corporations, PREMERA is seeking the approval of the Washington Attorney General regarding the distribution of the assets of PREMERA, PBC, and LifeWise Washington.

10. There are numerous transaction documents filed as exhibits with the Form A. However, there are certain documents that were the subject of significant discussion at the hearing that bear special note. They are the Transfer, Grant, and Loan Agreement ("TGLA"), the Voting Trust and Divestiture Agreement ("VTDA"), the Excess Share Escrow Agent

Agreement, the Registration Rights Agreement, and the BCBSA License Agreement. A brief description of each follows.

11. The Transfer, Grant, and Loan Agreement provides for the transfer of New PREMERA Stock to the Washington and Alaska Foundations upon the dissolution of PREMERA. The Foundations will be required to make distributions of proceeds derived from the sale of the stock to fund health initiatives in their respective states by making grants or gifts to one or more nonprofit organizations.

12. The Voting Trust and Divestiture Agreement sets forth the terms for the exercise of the voting rights of the New PREMERA shares to be owned by the Washington and Alaska Foundations. Under the terms of the agreement, while the Foundations will retain their economic interests in the New PREMERA stock, they are required to place 90% to 95% of the voting power of all New PREMERA stock in voting trusts administered by trustees. The trustees will generally be required to vote the shares as directed by an independent majority of the board of directors of New PREMERA. The VTDA also requires the Foundations to divest their New PREMERA stock so as to meet maximum ownership amounts at various anniversary dates following the date of the initial public offering of New PREMERA stock. The Foundations, in aggregate, will be permitted to own no more than 80% of the stock of New PREMERA following the first anniversary of the initial public offering, no more than 50% after the third anniversary, no more than 20% after the fifth anniversary, and no more than 5% after the tenth anniversary. If the Foundations fail to follow the divestiture schedule, New PREMERA has the right to compel a sale of any shares in excess of the maximum ownership limits. The excess shares will be deposited in an escrow

account so that they are available for sale by New PREMERA in accordance with the Excess Share Escrow Agent Agreement.

13. The Registration Rights Agreement sets forth the terms for the registration pursuant to applicable securities laws of the New PREMERA stock held by the Foundations in order to effect the divestiture of the stock. Among other restrictions on the Foundations' ability to freely sell their stock, New PREMERA decides the number of shares to be offered by New PREMERA, the Washington Foundation Shareholder, and the Alaska Health Foundation during the initial public offering.

14. The Blue Cross Blue Shield Association ("BCBSA") License Agreement will be entered into between New PREMERA and the BCBSA granting certain licenses to the Blue Cross trademark. The License Agreement allows New PREMERA and its Blue Cross subsidiaries to operate as for-profit companies on the condition that no institutional investor shall become the beneficial owner of securities representing 10% or more of the voting power of the company, no non-institutional investor shall become the beneficial owner of securities representing 5% or more of the voting power of the company, and no person shall become beneficial owner of 20% or more of the company's outstanding stock. However, these limitations do not apply to a Blue plan that is a beneficial owner of another Blue plan.[7]

B. Review of Premera's Reasons for Conversion

15. Premera's Application seeks permission to convert its nonprofit affiliates, Premera Blue Cross ("Premera" or "PBC") and LifeWise of Washington ("Lifewise") to for-profit companies.

[7] The term "Blue plan" refers to health plans that are licensed by the Blue Cross & Blue Shield Association.

16. Premera does not bear the burden of proving that conversion is necessary to its business survival. Consideration of Premera's stated reasons for conversion, however, is useful in reviewing the transaction as a whole.

17. Premera's primary stated reasons for conversion are: (1) to increase Risk-Based Capital ("RBC")[8]; (2) to improve products and services; (3) to support subscriber growth; (4) to preserve autonomy; (5) to operate on a level playing field with other health carriers; and (6) to improve retention of management .

18. Premera proposes raising $100 to $150 million at the Initial Public Offering ("IPO") and would have the option to raise additional capital in subsequent stock offerings.

19. Premera's RBC level was 433% as of December 31, 2003, increased from 406% as of December 31, 2002. If Premera had not incurred the $31 million + cost of its present effort to convert, its RBC level would have probably been greater than 450% at the time of the public conversion hearing in May 2004.

20. The Blue Cross Blue Shield Association ("BCBSA" or "Association") monitors a plan if its RBC level falls below 375%.

21. Pursuant to RCW 48.05.430 *et seq.* a company must take measures if its RBC level is 2.0 or 200%. The Office of the Insurance Commissioner will initiate regulatory review if a company's RBC level is 1.5 or 150%. Delinquency proceedings will commence if the company hits the mandatory control level of .70 or 70%.

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[8] RBC is "a method of measuring the minimum amount of capital appropriate for an insurer to support its overall business operations in consideration of its size and risk profile. It provides an elastic means of setting the capital requirement in which the degree of risk taken by the insurer is the primary determinant." The major categories of risk are asset risk, underwriting risk, credit risk, and business risk. *NAIC Health Risk-Based Capital Report* 10/01/03.

22. RBC levels at the end of 2002 for Blue plans comparable to Premera ranged from 245% to 846%, averaging 623%.

23. As was asserted by many witnesses on behalf of Premera and the OIC Staff, Premera is presently financially sound and can remain sound with or without conversion.

24. Premera's consultant, Donna Novak, testified that at its current RBC level Premera is capitally constrained. According to Ms. Novak a capitally constrained company must consider how proposed actions would affect its near term capital levels, which can result in a short-range business focus. Ms. Novak recommends that Premera's minimum RBC goal should be 500%. However, this is her generic recommendation for all Blue plans. Ms. Novak did not and was not asked by Premera to calculate the optimal RBC level for Premera based on its operational requirements.

25. Ms. Novak speculated, as she had not done the analysis, that increasing Premera's RBC to 500% could take more than five years. However, a review of the comparable plans offered by Ms. Novak shows that other nonprofit Blue plans (BCBS Minnesota, BCBS of North Carolina, and Care First of MD) increased their RBC levels in one year by 75 percentage points, 68 percentage points, and 75 percentage points, respectively.

26. Alternative methods for increasing RBC are debt financing and surplus notes. Premera could also generate RBC level increases through income and investments, which is how it was able to increase its RBC by 27 percentage points from 2002 to 2003, even as it spent heavily on conversion efforts.

27. I find persuasive OIC Staff consultant Jonathan Koplovitz's testimony that Premera is not capitally constrained. Instead, Premera has embarked on long term capital-intensive projects, including expansion into Arizona and the $125 million development of the

Dimensions product. In addition, Premera has not identified specific projects that are waiting for the capital Premera intends to raise. Nor has Premera calculated the costs and benefits of potential projects, or fully considered to what extent equity capital, as opposed to other sources of capital, is needed.

28. Mr. Koplovitz observed that, in his experience, Premera's approach to this transaction has been the opposite of other companies planning a conversion. Rather than having specifically-identified capital requirements dictate the need for a conversion and the amount of capital that should be raised, Premera has first decided how much it plans to raise at the IPO and will decide at a later date how that capital will be specifically used.

29. Premera asserts that it will be able to improve products and services for customers if it gains access to the capital markets as a for-profit company. Premera offers its success with the Dimensions product as a generic example of the type of project that it could undertake in the future given adequate capital. Premera witnesses also suggested possible improvements in its communications with providers and customers, as well as increased medical staffing and other programs within the Premera organization itself.

30. Premera, however, has not developed any specific product or service projects that it would implement if it had access to capital through the equity markets. It has not projected the funds it would dedicate to such projects. Nor has it calculated the administrative or medical expense savings, if any, it could make or would target to make by improving products and services.

31. All businesses, whether nonprofit or for-profit, must prioritize their initiatives. Premera represents that, regardless of whether it is permitted to convert, it will continue to

invest in products, services, infrastructure, and operational efficiencies, but that enhanced access to capital through conversion would help it to meet its goals more quickly.

32. Premera has targeted annual increases of 4% in its insured business and 5% in its administrative service business, regardless of whether it converts.

33. Premera believes that it can more easily achieve such targeted increases if it has access to equity capital. Premera further believes that improved services and products will attract more subscribers, and that an increased RBC level will support the risk associated with additional subscribers.

34. Large group contracts, such as Premera's contract with Microsoft, are often administrative service contracts ("ASC"). In ASCs the "insurance risk" remains with the employer, who pays an administrative fee to Premera to administer the employer's health plan. In ASC business, there is not a direct correlation between increasing the number of people served under the contract and the need to increase RBC, because Premera is not assuming risk on those contracts.

35. Premera is pursuing a strategy to obtain large "national accounts," similar to Microsoft, which would increase the percentage of its overall business represented by ASCs. Based on Premera's targeted growth in ASC business, ASCs would constitute a significant portion of Premera's business by 2007.

36. Premera's ASC business is currently not profitable. While the direct costs of the ASC business are being covered by the administrative contract fees, the fees are not covering allocated fixed costs, i.e. the ASC's share of overhead.

37. PriceWaterhouseCoopers October 27, 2003, *Economic Impact Analysis Report* provides a brief history of the consolidation and conversion of Blue Cross and Blue Shield plans.

38. The report states at page 101:

> The number of independent Blue Cross and Blue Shield plans has dropped from over 125 in the early 1980's to 63 in 1996 and down to 41 today. Initially, consolidation was primarily among geographically adjacent plans that retained not-for-profit status. Since 1995, over half of the states have seen consolidation activity among Blue Cross and Blue Shield plans and a visible subset of these have been acquisitions and for-profit conversions of Blues plans that had been organized as not-for-profit or mutual insurance companies under state insurance laws.

39. The growth of for-profit Blue plans began in the mid-1990's. The current marketplace has two multi-state, for-profit Blues plans, Wellpoint Health Networks and Anthem.

40. Early conversion efforts received more limited scrutiny from state regulators, as there was not a full understanding of the potential impact of conversions on the availability and affordability of health insurance and the need to protect the public's interests in the value of the converting Blue plan.

41. The formal conversion of the California Blue plan, WellPoint, in 1996 illustrates such problems. Wellpoint accomplished a *de facto* conversion in 1993 by creating a for-profit subsidiary, transferring all of the assets of the non-profit to this for-profit subsidiary, and issuing stock in the newly created for-profit. No public review considered whether the proposed *de facto* conversion was in the interest of the subscribers or the public. State officials were successful only after the fact in having proceeds from the sale of stock transferred to health care foundations for the public benefit.

42. Wellpoint has acquired Blue plans in Georgia, Missouri, and Wisconsin since converting to for-profit. It attempted to acquire CareFirst, a Blue plan that operated in Maryland, Washington DC, and northern Virginia, but the proposal was denied by the Maryland Insurance Commissioner.

43. Anthem was originally an Indiana Blue company. Since becoming a for-profit, it has acquired Blue plans in Kentucky, Ohio, Connecticut, New Hampshire, Colorado, Nevada, Maine, and Virginia. Its proposal to acquire the New Jersey plan was canceled, and the Kansas acquisition was denied by the Kansas Insurance Commissioner.

44. Wellpoint and Anthem presently have a merger application pending before other states' insurance regulators. A merger of Wellpoint and Anthem would leave only two for-profit Blue plans – Anthem/Wellpoint and WellCHOICE of New York.

45. WellCHOICE is the only independent for-profit Blue plan. Other Blue plans that initially converted to independent for-profits, i.e. were not acquired by a for-profit plan at the outset, have all since been acquired.

46. I agree with the views of Premera's CEO Gubby Barlow, Board Member Sally Jewell, and other witnesses, that Premera can best serve its subscribers and the Washington insurance-buying public by maintaining responsiveness to the needs of consumers and health care providers that derives from local management and autonomy. Negative effects of the loss of local control and ownership include those outlined in the *Premera Conversion Study, Report 2* at pages 29 to 35, prepared by the Health Policy Analysis Program of the University of Washington.

47. Premera's states that it has no plans of being acquired. Based upon the experience of other converted plans, however, there is a high likelihood that if Premera

converts to a for-profit company, it will be acquired by a national insurer such as Anthem or WellPoint. As several witnesses testified and history indicates, once a nonprofit plan converts, the road to a subsequent acquisition can be appealing to management and is relatively easier.

48. A for-profit Premera board of directors would have a fiduciary responsibility to its shareholders to maximize shareholder value regardless of the CEO's and the board's present intention to remain independent. For example, if Premera were faced with a purchase offer at more than its then-existing share price (as was the case when WellPoint offered to purchase RightCHOICE, the converted Missouri Blue, at double its share price) the financial rewards of such a buy-out to shareholders would have to be given primacy by the Premera board and management over the benefits of local ownership and control to Premera subscribers and to the Washington insurance-buying public.

49. The risk is great that, contrary to Premera's goal of retaining independence, conversion would result in the loss of that independence.

50. Premera has also asserted that it should be permitted to convert to a for-profit in order to be able to operate on "a level playing field." The playing field in Washington is presently dominated by nonprofit health carriers. The two largest carriers, Premera and Regence, are nonprofit Blue plans. As of 2002, Premera and Regence had roughly equal shares totaling approximately 56% of insured business. The third major Washington carrier is the nonprofit Group Health, which has about 19% of the insured market. In total approximately 75% of the insured Washington market is currently being served by nonprofit health carriers, with the remaining 25% divided among national carriers and small local or

specialized plans, none with more than a 6% market share. Premera operates on a level playing field.

51. In making its decision to convert, the board of directors believed that becoming a publicly-held company would strengthen retention through the use of equity incentives such as stock options and other stock-based awards. However, the need for equity incentives is not supported by the data. PriceWaterhouseCoopers studied Premera's turnover rates and found that company-wide turnover rates were significantly lower than industry rates, as were turnover rates for executive management. In addition, Premera has generally implemented above market compensation practices in comparison to similarly-sized Blue plans, with senior vice-presidents and the top five executives receiving total compensation significantly above market. (Issues regarding compensation are discussed in more detail in Section H of the Findings.)

52. There are negative financial impacts of conversion. Premera will be at risk to lose certain favorable tax attributes that could raise its book tax rate from 20% to 35% in the near term and its cash tax rate in the longer term. (Tax issues are discussed in more detail in Section G of these Findings.) Its premium tax in Alaska will be raised to 2.7% from 2.0%. Premera has estimated that it will have ongoing public company expenses annually of $3.5 million.

53. Premera believes that conversion would permit it to achieve "strategic flexibility" by obtaining access to additional capital from the equity markets. However, Premera has planned for and can successfully pursue its objectives of improved services and products, growth, and increased operational efficiencies without converting to a for-profit.

54. I am persuaded that the speculative benefits that might flow from Premera's added strategic flexibility, if any, would not outweigh the likelihood of harm to subscribers, to the insurance-buying public, and to the public interest, as further explained in this Final Order.

C. Review of Economic Impact of Conversion

55. Among the issues presented by the governing statutes are 1) whether the resulting entity's plans for material change are unfair and unreasonable to its policyholders and not in the public interest, and 2) whether the transaction is likely to be hazardous or prejudicial to the insurance-buying public. Both issues require me to consider potential future impacts of the proposed transaction.

56. Evidence was introduced as to whether a for-profit Premera would lower provider reimbursements, raise premiums by more than the market rate of increase, pull out of less profitable markets, and/or take other problematic actions. Evidence was also introduced as to a for-profit Premera's projected net income, growth, and operating margins.

57. PriceWaterhouseCoopers' *Economic Impact Analysis* ("the PWC Analysis"), which I find credible and accept, studied Premera's current and projected income, expenses, and target operating margins in individual, small group, large group and administrative service contract lines. PWC analyzed Premera's projections through 2007, and made findings and conclusions about Premera's projected and target operating margins for each line of business.[9] Individual lines have historically been the least profitable and in most recent years have been unprofitable.

[9] The information as to projections for each line of business and PWC's findings and conclusions as to that information is set forth in the substantive portions of pages 65 through 74 of the PWC Analysis, but has been redacted from the public version because the information is confidential. This decision will discuss all such confidential items very generally. Attachment B to this Final Order, which is subject to Attorneys Eyes Only confidentiality protection, discusses the confidential PWC findings and conclusions which support my decision.

58. Small groups, while not subject to all of the same pressures as individuals, have fewer options (such as self-insurance) than large groups and generally do not wield the same bargaining power as large groups.

59. PWC's Analysis[10] concluded that, to meet the margins demanded by the financial markets, premiums must increase, or administrative costs or provider reimbursements must decrease. PWC concluded that such premium increases are constrained by the competition in Western Washington but are not so constrained in certain counties in Eastern Washington where Premera has market power. PWC concluded that, because of Premera's smaller market share in the large group line and large groups' ability to self-insure, the premium increases necessary to meet Premera's target margins could not be successfully imposed on that group. PWC further concluded[11] that Premera has sufficient market power in certain Eastern Washington counties in the small group and individual lines to impose the premium increases necessary to meet such target margins.

60. The PWC Analysis also concluded that, to reach the operating margins demanded by the financial markets, premium increases of 8% to 10% for the individual line of business in 16 counties in Eastern Washington where Premera has market power would be required. PWC further concluded that, to reach the operating margins demanded by the financial markets, premium increases of 2% to 4% for the small group line of business in 18 counties in Eastern Washington where Premera has market power would be required.[12]

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[10] Cantilo & Bennett's October 2003 Final Report, at pages 66 – 73, reached came to the same conclusions.

[11] PWC's conclusion in this regard was in part based on the work done by Dr. Leffler.

[12] PWC's model used those counties where Premera has at least a 65% market share.

61. I believe that to satisfy the investment community Premera, as a public company, would be required to produce continuous and significantly increased growth in such key metrics as net income and operating margins.

62. Premera chooses to downplay these benchmarks used by investors. Instead, it prefers to focus on projected growth in membership and revenues. However, PWC concluded that Premera would face serious challenges to its growth in Washington because this state already has a higher rate of health insurance coverage than the national average, as well as a relatively high unemployment rate and slowing population growth. Although revenue is one factor in looking at a company's financial condition, it is tied to membership growth. An increase in revenue may also simply reflect increased premiums due to inflation in the costs of medical care.

63. Premera's witnesses Gubby Barlow, Chief Executive Officer, and Audrey Halvorsen, Senior Vice President and Chief Actuary, suggested that Premera would be able to increase margins through administrative cost savings. Premera did not specify how such savings could be achieved.

64. Premera did not present evidence of what level of savings, if any, its recent IT improvements have achieved, or what level future investments would be expected to bring.

65. Premera did not present credible evidence of what level of savings, if any, its care management programs would be expected to bring.

66. PWC believes Premera would be forced by the investor markets to allocate to each line of business its full cost. Premera's ASC business currently is not bearing its fully

allocated cost and would require a 28% increase in price in order to do so.[13] However, Premera has also said that the ASC business is highly competitive. It does not seem likely that Premera will be able to raise the price by 28% and still achieve significant growth, which would also affect the net income measure.

67. PWC[14] also concluded that Premera's projected margins were lower than those of comparable companies and that it would be difficult for Premera to be viewed as attractive to the stock market unless it was able to improve its financial performance. PWC also noted that a for-profit Premera would have additional administrative costs for financial reporting and investor relations.[15] PWC concluded that Premera's only remaining options for achieving its target margins or the margins expected by the investor community would be to raise premiums and/or lower provider reimbursements.

68. Premera and the OIC Staff retained economists[16] to analyze whether a for-profit Premera would be able a) to raise premiums more than necessary to cover its costs, and/or b) to lower provider reimbursements. The economists agreed that the ultimate question was whether Premera has market power, that is: Does Premera have the ability to increase prices (or lower provider reimbursements) by at least a small but significant and nontransitory amount? I find more credible and generally accept Dr. Leffler's testimony, founded on his broad experience working on antitrust cases for the Department of Justice ("DOJ") and the Federal Trade Commission and his application of the Department of Justice/Federal Trade Commission Horizontal Merger Guidelines, (DOJ/FTC Guidelines").

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[13] Failure of the ASC business to meet its target would negatively affect all other lines of business, particularly in future.

[14] See also Cantilo & Bennett's October 2003 Final Report at 70.

[15] Mr. Klopovitz testified that Premera estimated approximately $3.5 million in costs annually associated with being a public company, and he estimated it might be even higher.

[16] Premera retained Thomas R. McCarthy, Ph.D., the OIC Staff retained Keith Leffler, Ph.D.

69. Both experts considered the relevant economic market. Dr. McCarthy concluded that the relevant market is all health insurance products in Washington, including self-insured products and all public or government lines of business distributed or sold by commercial insurers. Dr. Leffler concluded that only commercial insurance products should be considered,[17] and that large group, small group, and individual products in each metropolitan area should be analyzed separately. Dr. Leffler concluded that, even considering larger geographic areas such as all of Eastern Washington and all of Western Washington, Premera's market share showed its dominance in Eastern Washington.[18] Dr. Leffler found that Premera's market share of the insureds reporting to the OIC for individual, small and large plans for the year 2001, the most recent year for which reliable data was available, exceeded 80% in eight counties in Eastern Washington and averaged nearly 70% over all of Eastern Washington. He also found that, in the 14 Eastern Washington counties where Premera has exclusive use of the Blue Shield/Blue Cross mark, it averages a 90% market share.

70. Dr. Leffler testified that, of the four examples Dr. McCarthy offered of successful market entry by Premera competitors into Premera's Eastern Washington markets, one was an existing carrier's acquisition of another existing carrier, another entered and failed, another had very few enrollees in the small group and individual market in the 14 counties, and the last was not an insurer.[19] Further, Dr. Leffler noted, of the six examples Dr. McCarthy offered of successful expansion, one was the same failure he cited as evidence of

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[17] Although Dr. Leffler did not include any government programs (state and federal employee programs, Medicaid or Medicare), he did include self-insurance as a demand substitute for large groups.

[18] Dr. Leffler also testified that, whether he measured market share in the 14 county area for individual and small group separately or collectively, the result was substantially the same.

[19] TR. At 1767, 1768

successful entry, and the others were carriers which have been offering the same line of business as Premera, so they are not examples of successful carrier expansion into new lines in this area.

71. Dr. Leffler testified that self-insurance may be viable for large employer groups, but is not a realistic alternative for small employers or individual purchasers. Further, insurance regulations for each classification are significantly different. Dr. Leffler concluded that to analyze Premera's market share, the relevant market should be divided into large group, small group and individual commercial insurance products.

72. Once the relevant market is defined, market share can be determined. Further analysis is then necessary to determine whether market power exists. If market share is less than 60%, no further analysis is necessary. In the present case, however, because Premera's market share in the 14 Eastern Washington counties where it has exclusive use of the Blue mark greatly exceeds 60%, analysis of market power with respect to those markets is necessary.

73. Dr. Leffler's analysis, consistent with the DOJ/FTC Guidelines, considered possible supply substitutes as pertinent to the ultimate issue of whether Premera has market power.[20] He concluded that, because Premera's market share of the large group market was smaller than it was in the other categories (small group and individual), and because large groups may self-insure, Premera did not have market power in the large group market, even in the 14 counties.[21]

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[20] Both Dr. Leffler and Dr. McCarthy agreed that market share is the starting point, but does not in itself demonstrate whether an entity has market power.

[21] Dr. Leffler's analysis proves much more helpful than Dr. McCarthy's, by enabling me to consider how real world options affect the ultimate question of market power.

74. Dr. Leffler considered other supply substitution possibilities in the 14 counties and concluded that substantial barriers to entry and expansion exist for other carriers. Dr. Leffler reasoned that to compete effectively with Premera, a carrier must establish an extensive provider network essentially mirroring Premera's, because employees are reluctant to switch providers. Employers are also reluctant to undertake the administrative costs of switching to a new carrier. A carrier switch in the largely rural areas at issue generally requires that both the employer and the carrier have a relationship with a health plan broker servicing that area. As Dr. Leffler noted, buyers are also reluctant to switch coverage when the firm seeking their business is new to the market and may be gone if its effort to enter the market is unsuccessful. Premera's exclusive right to use the Blue Shield and Blue Cross marks in the 14 counties also serves as an impediment to entry/expansion by other carriers.[22] Dr. Leffler concluded that Premera has market power in a 14 county area of Eastern Washington.

75. Dr. Leffler considered whether Premera had exploited its market power with respect to premium rates. He opined that, because state regulation of small group and individual health plan pricing requires revenue neutrality, the price of Premera's Eastern Washington products is tied to the price of those products in the Western Washington market. Therefore, Dr. Leffler concluded, because the Western Washington market is competitive, revenue neutrality in effect means that Premera is prevented from raising the price of its Eastern Washington products beyond medical cost trend. However, Dr. Leffler is not an expert in insurance regulation (TR. at 1784-85) and later testimony by those who have more

[22] As discussed above, Dr. Leffler also considered the examples offered by Dr. McCarthy, and concluded that none represented successful entry or expansion.

expertise in that field shed a different light on Dr. Leffler's conclusion with respect to the effect of state price regulation. See particularly the testimony of Lichiou Lee and Martin Staehlin discussed below.

76. Dr. Leffler also analyzed whether Premera had market power with respect to purchasing provider services. Dr. Leffler found that Premera controls 73% of the commercially-insured patient population in the 14 county area. Using Dr. McCarthy's calculation of the numbers of self-insured in Eastern Washington, Dr. Leffler estimated that, including the self-insured, Premera controls approximately 70% of the commercially-insured and self-insured population in the 14 county area. Dr. Leffler compared provider reimbursements of two competing carriers in the 14 county area for 123 common procedure codes with Premera's provider reimbursements and determined that Premera pays less[23] than those competitors in reimbursements for care to small group enrollees. Dr. Leffler concluded that Premera had buying-side market power in the 14 county area, but that Premera had already exercised that power with respect to provider reimbursements.

77. PWC's analysis concluded, consistent with Dr. Leffler's views, that in those counties in Eastern Washington where Premera had a 65% or greater share of the individual and small group market,[24] it had sufficient market power to raise its premiums at least a small but significant and nontransitory amount. PWC also agreed with Dr. Leffler that Premera did not have a sufficient market share in Western Washington to have market power and that large

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[23] The specifics of Premera's reimbursement differences are set forth in S-115, but the information is confidential.

[24] PWC identified 16 counties with the requisite market share in the individual line and 18 counties with the requisite market share in the small group line. Dr. Leffler's analysis omitted 2 of PWC's counties for the individual line and 4 of those in PWC's small group category because his break point was more demanding. He ended up using only the 14 counties where Premera had exclusive use of the Blues brand and a certain market share, which is more full explained in confidential Attachment B.

groups' access to self-insurance in Eastern Washington weakened Premera's market power in that line.

78. PWC created a model to study what would happen in the 14-county area of Eastern Washington if Premera used its market power to raise premiums to meet its target margins. I find credible and accept PWC's conclusion that, if Premera does not lower provider reimbursements[25] or lower its administrative costs beyond its projections, it will have to raise premiums in the 16 county area significantly[26] above market trend in the individual line and in the small group line in the 18 Eastern Washington counties to meet its target operating margin for the individual and small group lines of business.

79. OIC's Chief Actuary, Lichiou Lee, noted, and Audrey Halvorsen, Premera's Chief Actuary generally agreed, under Washington insurance law, the OIC does not have authority to disapprove individual rates, which are filed for informational purposes only.

80. Ms. Halvorsen testified that Premera's increase of rates and margins in the small group market in the 14 county Eastern Washington area to meet target margins would violate Washington insurance law, which requires overall revenue neutrality. Under the principle of revenue neutrality, any increase of profitability in the 14 counties must, according to Ms. Halvorsen, be balanced by a corresponding decrease of profitability elsewhere.

81. Ms. Lee, whose testimony I find credible and accept, agreed that the Washington law requires revenue neutrality, but noted that a slight alteration in the design of

[25] All parties concluded that the competition in Western Washington prevents Premera's lowering provider reimbursements there. Dr. Leffler concluded that Premera's provider reimbursements are already lower than its peers in Eastern Washington and considerably lower than its Western Washington reimbursements, presumably due to Premera's exercise of its market power in the 14 Eastern Washington counties where Premera has exclusive use of the Blues brand.

[26] The specific necessary percentage is confidential and in Attachment B.

an existing insurance product would create a new product, not subject to the revenue neutrality requirement.

82. Mr. Staehlin, whose testimony I find credible and accept, explained that rate filings are composed of hundreds of elements for each of the factors that permit carriers to adjust rates. Mr. Staehlin agreed with Ms. Lee that one way to sidestep the revenue neutrality requirement is to alter a product's characteristics slightly and treat it as a new product, thereby negating the prior product's claims experience and allowing a carrier to use "actuarial judgment" to fill the gap. Mr. Staehlin's testimony demonstrates that the actual complexity of rate filings and a carrier's ability to make alterations such as ones he and Ms. Lee suggested would enable Premera to achieve its target margins by raising premiums or taking other anti-competitive actions in those areas where it has market power.

83. Premera has proposed economic assurances that are intended to mitigate the affect of the conversion on premiums for the individual and small group markets in Eastern Washington. To the extent the assurances offer any mitigation, it is only for two years, after which time the assurances expire.

84. The assurances are also, as a practical matter, mostly ineffective. Because the rates in the individual market are not approved by the OIC and are essentially unregulated, the assurances will not constrain individual rates. In addition, as testified to by OIC Actuary Lichou Lee and expert actuary Martin Staehlin, there is also a considerable amount of maneuverability that Premera will retain in rating products in the small group market. By simply adjusting benefits in any given small group product, the assurances become ineffective.

85. Premium increases beyond market trend would pose an unacceptable risk that consumers would have to forgo insurance coverage resulting in patients deferring or avoiding

medical care, not following prescribed treatments, and over utilizing emergency rooms. The public witnesses, particularly in Eastern Washington, overwhelmingly raised the concern that, with few to no alternatives to Premera for coverage, premium increases would price them out of insurance and jeopardize their ability to obtain medical care.

86. Report 2 of the UW Health Policy Analysis Program cited results of an annual study by the California Medical Association which found that, of the ten managed care health plans that spent the largest proportion of premium revenue on health care, eight were non-profits. The HPAP study also found that the medical loss ratio of WellPoint, the nation's oldest converted Blues plan, was lower than all of its major competitors. Similarly, Missouri's converted Blues plan, subsequently bought by WellPoint, has decreased its loss ratio since conversion and now has the lowest loss ratio of all its major competitors. The HPAP Report also noted a report by Conover C. and M. Hall, *For-Profit Conversion of Blue Cross and Blue Shield of North Carolina: Assessment of the Potential Impacts on Accessibility and Affordability of Health Care, Report to the North Carolina Department of Insurance* April 2003, which established that loss ratios for investor-owned Blues plans have been about 10 percentage points lower than for nonprofit Blue plans.

87. I believe that the risk in the present case of decreased spending on medical care is unacceptable. To permit conversion in view of this risk would be unfair and unreasonable to Premera's subscribers and not in the public interest, and would be hazardous and prejudicial to the insurance-buying public.

88. I believe that the risk of excessive rate increases, as described by PWC's model, is unacceptable. To permit conversion in view of this risk would be unfair and

unreasonable to Premera's subscribers and not in the public interest, and would be hazardous and prejudicial to the insurance-buying public.

D. Review of Premera's Obligation to Transfer Fair Market Value to the Foundations

89. Premera asserts that it has no charitable trust obligation and, therefore, is not required to transfer its assets upon dissolution to a nonprofit entity that is engaged in similar beneficial activities. Premera contends that its transfer of assets to the Foundations would constitute a voluntary gift, upon which it may place whatever restrictions it chooses, even if such restrictions dilute or decrease the value of the assets.

90. Premera further asserts that the Foundations are entitled only to the value derived from the stock with the restrictions in place. Premera likens this to gifting a piece of property subject to a mortgage or an easement.

91. Premera's obligation to convey all of its assets upon dissolution existed, however, before it created restrictions on the sale and control of the stock. The fact that Premera has, for its own reasons, elected to convey its assets by transferring the value of the company through stock does not relieve it of the obligation to transfer what would have been the fair market value of those assets had it performed an independent appraisal or entered into an arms-length negotiated sale.

92. Neither Premera nor the OIC Staff undertook the legal and factual analysis to determine if Premera's assets are held as a charitable trust under Washington law. The OIC Staff reasonably assumed, based on Premera's representations to me, the Attorney General, and in the Form A, that Premera's conversion plan was intended to convey fair market value to the Foundations. It was not until after the OIC Staff consultants issued their final reports in October 2003, in which they identified certain restrictions and provisions in the transaction

documents that would affect the value of the stock to the Foundations, that Premera claimed it neither intended nor was obligated to convey fair market value.

93. Regardless of whether a charitable trust exists, Premera is obligated to transfer the fair market value of its assets to the Foundations by the terms of the Form A and by the requirements of its Articles of Incorporation, the Washington Nonprofit Corporation Act, and the Holding Company Act.

94. Premera is a nonprofit corporation organized under the Washington Nonprofit Corporation Act, Chapter 24.03 RCW. Its parent, PREMERA, is a nonprofit corporation formed under Chapter 24.06 RCW. Premera's predecessor was formed in 1945 by the Washington Hospital Service Association under the charitable corporation laws for the purpose of providing hospital care to subscribers and thereby promoting their general and social welfare. In the 1990's the Medical Service Corporation ("MSC") was acquired by PREMERA and later merged into Premera Blue Cross. MSC was a nonprofit entity formed by physicians to "secure to low wage earners and to their families, health services . . . of which many such individuals and their families have heretofore been deprived."

95. Premera is not owned by its directors, officers, or members, and no part of the income of the company is distributable to its directors, officers, or members. RCW 24.03.005(3).

96. As Premera Board Member Sally Jewell testified, the board of directors' decision to structure the reorganization whereby "100 percent of the value – 100 percent of the stock was transferred to the foundation[s]" was a recognition that the "accumulated capital of Premera over time since it was founded in the '40s here [Washington] and in the'50s in

Alaska comes from the retained earnings and the operating margins of many, many, thousands of people in those states, residents in those state over the years."

97. Article VIII of Premera's Articles of Incorporation states that upon dissolution, all of the proceeds of its assets must be distributed to its parent, PREMERA. Article XII of PREMERA's Articles of Incorporation states that upon winding up and dissolution, PREMERA's assets shall be distributed to "one or more nonprofit entities to be used exclusively for purposes consistent with the purposes" of PREMERA.

98. The reorganization plan outlined in the Form A provides for the dissolution of Premera and its nonprofit parent, PREMERA. RCW 24.03.225(4) and 24.06.265(3) requires that a dissolving nonprofit corporation distribute its assets in accordance with its articles of incorporation or bylaws.

99. Premera submitted the Form A to the Attorney General for review pursuant to RCW 24.03.230, thereby acknowledging her authority to review Premera's plan of distribution of assets in accordance with RCW 24.03.225(3). RCW 24.03.225(3) requires that upon dissolution, assets of a nonprofit company "received and held by a corporation subject to limitations permitting their use only for charitable, eleemosynary, benevolent, educational or similar purposes . . .shall be transferred or conveyed to one or more" entities engaged in substantially similar activities to those of the dissolving corporation.

100. In letters to the Insurance Commissioner and the Attorney General, dated May 30, 2002, Premera explained that "[a]fter completion of the reorganization, the [Foundations] would hold 100% of the initial stock of New PREMERA, *representing the entire ownership interest of New PREMERA at the conclusion of the reorganization.*" Emphasis added.

101. The Form A describes the transfer to the Foundations variously as "100% of the stock of New PREMERA," or "100% initial ownership of New PREMERA," or "100% of [New PREMERA's] assets."

102. In reviewing the Form A under the Holding Company Act, I must review the terms of the transaction, including the "source, nature, and amount of consideration used or to be used in effecting the acquisition of control, a description of any transaction in which funds were or are to be obtained for any such purpose, including a pledge of assets, a pledge of the health carrier's stock, or the stock of any of its subsidiaries or controlling affiliates, and the identity of persons furnishing the consideration." RCW 48.31C.030(2)(b).

103. Information regarding the consideration to be paid is relevant to determinations under the Holding Company Act of whether (1) the newly acquired domestic carrier is able to satisfy the financial requirements for being a health carrier after the acquisition; (2) the financial condition of the acquiring party might jeopardize the financial stability of the health carrier or prejudice the interest of its subscribers; (3) plans of the acquiring party to liquidate the health carrier, sell assets, or make other material changes are unfair and unreasonable to subscribers of the health carrier and not in the public interest; and (4) the acquisition is likely to be hazardous to the insurance-buying public. RCW 48.31C.030(5)(a).

104. Reviews of transactions under the Holding Company Act typically examine the consideration paid to assure that the domestic company and, in turn, its subscribers are not being harmed or prejudiced by receiving less than fair value. In addition, the nature and source of the financing is important to ensure that neither party to the transaction is being compromised financially by engaging in the transaction.

105. Because Premera is not seeking to convert by being acquired by another insurer, there is no arms-length negotiated purchase price to establish value. Premera did not propose conveying the dollar value of its assets based on an independent appraisal - including but not limited to its investments, goodwill, contract rights, intellectual property rights, hardware, and software. Premera would understandably not convey its actual assets to the Foundations because that would put the company out of operation. Rather, Premera has elected to undergo a stand alone conversion by issuing stock and conveying that stock to the Foundations, which would realize the value of Premera's assets by monetizing the stock over time.

106. When an acquisition is between a buyer and a seller negotiating at arms length, the assumption is that the amount of the consideration and the structure of the financing will be fair. Indeed, each party generally obtains a fairness opinion from its bankers or consultants to that effect before consummating the transaction.

107. An acquisition as a result of a stand alone conversion from nonprofit to for-profit presents different issues relating to consideration under the Holding Company Act. First, there are not two parties negotiating at arms length over a purchase price. Instead, the terms of the transaction are controlled, except for my review, by the company converting. Second, the value to be received is not a specific dollar amount derived from a sale, but is derived from the issuance of stock that will be monetized over time.

108. The only way to judge the fairness of the value produced under these circumstances is to review process and terms for issuing, controlling, and monetizing the stock. Assuming that the process and terms are fair and reasonable, one can reasonably assume that the dollar amount that ultimately will be derived represents the fair market value. Further,

because Premera is not owned by its management or shareholders, I must also take into account the public interest in receiving the beneficial value of the company.

109. The Legislature did not limit my review under the Holding Company Act of issues relating to the source, nature, and amount of the consideration simply because the acquisition of control takes place via a stand alone conversion rather than a third-party sale. Indeed, the fact that the present transaction is not the result of arms-length negotiation makes regulatory review even more important.[27]

110. I must also consider Premera's obligations to comply with its own Articles of Incorporation and the Washington Nonprofit Corporation Act. Otherwise Premera could undertake a transaction in violation of the law that later could be challenged or overturned, resulting in damage to the company and harm to its subscribers.

111. The OIC Staff consultants opined that, even though Premera did not perform a valuation and commit to transfer a fixed fair market value dollar amount to the Foundations, a properly run IPO and properly structured transaction could still result in the transfer of fair market value.

112. As is discussed in more detail below, Premera's plan to raise $100 to $150 million will significantly dilute the value of the sock to be received by the Foundations. Additionally, Premera has placed an array of restrictions and conditions on the Foundations'

[27] In reality, Premera's entire reorganization and conversion plan is an intercompany transaction. All of the assets, represented by shares of stock, are being transferred from the nonprofit Premera holding company system and being acquired by the for-profit Premera holding company system. The same board and management are controlling the terms of the transfer and the acquisition. Intercompany transactions are governed by a standard of whether the terms are fair and reasonable. RCW 48.31B.030 and 48.31C.050. This standard is necessary to prevent conflicts of interest and financial self-dealing. Premera asserts that this standard does not apply to a Form A. I believe it is a reasonable interpretation of my authority to review a Form A to consider whether the terms of the acquisition are fair and reasonable as part of my decision on whether the transaction is unfair and unreasonable to subscribers, not in the public interest, or hazardous or prejudicial to the insurance-buying public. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.015(4)(a)(vi); RCW 48.31C.030(5)(a)(ii)(C)(IV).

ability to exercise control of the stock and divest the stock. Because of these problems, the OIC Staff's investment banker consultants are unable to opine that the transaction as a whole is fair to the public from a financial point of view.

E. Review of Dilution of the Value of the Stock to the Foundations

113. There are three types of dilution to the value of stock. The first is ownership dilution, which means in this context that, although at the time of the conversion the Foundations will own 100% of the newly issued stock, their ownership interest will be reduced when New PREMERA sells additional stock in the IPO. This may not result in a reduction in value to the Foundations, as Mr. Koplovitz from the Blackstone Group testified, if in fact the "pie is bigger." However, in order for the pie to be bigger, the additional issuance of stock by Premera must result in increased earnings and an increase in value of the company.

114. Earnings dilution looks at expected earnings to determine if, taking into account the expense of raising equity capital, that capital will be used in a manner that will increase earnings. The Blackstone Group has calculated that Premera's plan to raise $150 million and place the money in bonds is 15% dilutive to the earnings of the company. The result of this dilution is that the price that the Foundations will be able to receive for their stock, which is based in part on the earnings of the company, will be reduced. Blackstone opined that the amount of dilution is excessive and not fair to the Foundations and the public. I accept that opinion.

115. The last type of dilution is value dilution, which looks at the long term use of the capital. Equity capital is expensive to raise. If the capital is not used in a manner that increases value over the long term, there will be dilution of value resulting in lower stock prices and, therefore, reduced proceeds for the Foundation.

116. In conversions of this kind in other states, the converting plans did not raise the amount of capital that Premera is planning to raise. In addition, it has been the experience of the OIC Staff's consultants that companies intending to convert to for-profit to raise capital have prepared much more definitive plans for the use of that capital, so there can be an analysis as to whether the planned capital projects will increase the earnings and value of the company.

117. In the amended Registration Rights Agreement and Plan for Conversion in the Form A, Premera agreed to consult with IPO Advisors acting on behalf of the Foundations regarding the pricing, amount, and allocation (as between New PREMERA and the Foundations) of the securities to be offered at the IPO. The Washington Foundation's IPO Advisor, presumably the Blackstone Group, could also issue an IPO procedures opinion just prior to the IPO to opine on whether the IPO was marketed and conducted fairly and in the customary manner. However, my decision on the Form A is based on the representations by Premera that it intends to raise $100 to $150 million from the IPO and that currently there are no specific plans for that capital other than purchasing bonds. This will result in significant dilution in value of the shares to the Foundations.

118. The opportunity for the IPO Advisor to consult and issue a procedures opinion on the eve of the IPO is not a substitute for presenting to me a conversion plan prior to a decision on the Form A that shows Premera's intention and ability to transfer fair market value to the Foundations. Premera has not done that; therefore its plan for conversion is not fair and reasonable to the public and not in the public interest.

F. Review of Restrictions on Control and Sale of Stock

119. Each Blue plan is required to sign a license agreement with the Blue Cross and Blue Shield Association. The agreement contains a provision that, if the plan becomes for-

profit, it will lose its license if any individual owns five or more percent of the stock or any institutional investor owns ten or more percent of the stock. These limitations do not apply to the ownership interest of another Blue plan.

120. The BCBSA has made accommodations regarding this license provision where stock was issued to a foundation or similar entity as part of a conversion plan.

121. The license also requires that the members of the board of directors pre-conversion must remain in control post-conversion.

122. Other than these two restrictions in the license agreement, no other conditions on converting to for-profit are issued by the BCBSA in a written agreement or written guidelines.

123. Premera has not received an explanation from the BCBSA of the reasons for the conditions purportedly required by the BCBSA in this transaction.

124. The BCBSA is managed by the CEOs of all the Blue plans.

125. Premera asserts that if it undertakes a transaction without the conditions that the BCBSA has purportedly placed on Premera, Premera will lose its license.

126. The Blue license is a valuable asset. Premera would not convert, if conversion resulted in the loss of the license.

127. I am not bound by conditions that BCBSA may place on its plans to allow them to convert and still retain a license. I may find that any one condition or combination of conditions constitutes reason for disapproval of the Form A.

128. Premera has placed restrictions on the Foundations' ability to control and trade the stock and to have its interests represented.

129. The Voting Trust and Divestiture Agreement ("VTDA") treats the Foundations as single entity for purposes of the mandatory divestiture schedule and the ability to vote their shares of stock. The Foundations are required to sell their shares of stock so that together they own less than 80% of the issued and outstanding shares of stock prior to year one, 50% prior to year three, 20% prior to year five, and 5% prior to year ten. In addition, the Foundations are permitted (with some exceptions discussed below) only to vote one share less than 5% in the aggregate of the outstanding shares of common stock.

130. The Foundations are separate entities, with separate boards that are appointed by each state's respective public officials. The Foundations will have separate missions and serve different constituencies. They are likely to have different interests and different plans in how they desire to monetize the stock. But for the restrictions placed on the Foundations by the VTDA, they would be separate individual investors entitled to exercise up to, but less than, 5% ownership rights under the BCBSA license agreement.

131. While public investors may view a predictable plan for divestiture favorably, the mandatory divestiture schedule deprives the Washington Foundation of significant control over its shares, which may force the Foundation to sell its shares during a downturn in the market. An aggregated divestiture schedule exacerbates the problem of lack of control, because it may force the Washington Foundation to sell shares that it would not be required to under an individual schedule.

132. The Foundations are further stripped of control over their stock by being required to vote their shares in the aggregate. The Foundations, which will initially own 100% of New PREMERA, will be required to contribute 95% plus one share to the voting trust and to make further contributions from time to time so that so that the number of shares controlled

outside the voting trust by the Foundations in the aggregate never exceed one share less than 5% of the outstanding stock. If the Foundations can not agree on how to divide the voting power, the Washington Foundation may vote all of the voting shares.

133. Investors may look favorably at a significant contribution by the Foundations of voting power to the trust. However, requiring the Foundations to vote the small percentage allotted to them in the aggregate further deprives them of control over their shares, treats them less favorably than other individual investors would be treated under the BCBSA license agreement, and places the Foundations in conflict with each other.

134. Premera suggests that conflicts between the two states' Foundations regarding divestiture and voting power should be resolved by the Foundations when they arise. However, I am persuaded that it is not in the public interest to structure the transaction so that the Foundations will be placed in inherent conflict with each other. In addition, as recommended by the OIC Staff consultants, the divestiture deadlines should apply individually to each Foundation so that the Washington Foundation can meet ownership deadlines on the shares it owns and controls. Also as recommended, the Washington Foundation should be free to vote in its own right one share less than 5% of the outstanding shares of stock. I am persuaded that the Foundations will have ceded significant control by complying with a divestiture schedule and voting trust, and that forfeiting more control through aggregated divestiture obligations and voting rights is not fair and reasonable and further reduces the value of the stock to the Foundations.

135. The VTDA also requires that the Foundations own no more than 80% of the outstanding shares of stock one year after the IPO. The Blackstone Group recommends that

this provision be eliminated. Premera asserts that this is a BCBSA requirement, although it was not included in the WellCHOICE conversion.

136. There are perceived benefits by investors of predictable divestiture. However, this first year requirement places the Foundations at risk of potentially having to sell additional shares in a relatively short time after the IPO when the market may not be advantageous. The fact that the divestiture obligation is aggregated with the Alaska Health Foundation exacerbates the potential risk to the Washington Foundation. I am persuaded that the combination of these two factors reduces the value of the stock. In addition, the perceived benefit by public investors of a forced divestiture of this amount the first year is questionable in light of the fact that such a provision was not required in the WellCHOICE conversion.

137. There are numerous other provisions, as described below, that further restrict the Foundations' ability to exercise control over their stock, to be represented consistent with their ownership interests, and to participate freely in the governance of New PREMERA on material issues. I am persuaded that these restrictions unreasonably interfere with the Foundations' interests and thereby reduce the value of the stock to the Foundations.

138. The VTDA permits the Foundations to freely vote their shares, i.e. the trustee must vote the shares in trust as the Foundations direct, on a change of control proposal resulting in New PREMERA shareholders owning less than 50.1% of the company post-transaction. The Blackstone Group recommends that the Foundations be given the right to freely vote their shares if a change in control proposal results in the New PREMERA shareholders owning less than 80% of the company, because such transactions would have a material impact on the value of the Washington Foundation's ownership interest in New PREMERA. This recommendation is consistent with the New York Stock Exchange rules

which indicate that, if a company issues more than 20% of its shares as new shares, it must obtain the approval of its stockholders.

139. The Washington Foundation is permitted to nominate a member of the board, who must meet stringent qualifications, including experience on a board or as an officer of a public company or partner/managing director of a national firm, as specified in the VTDA. The member is selected by Premera's board of directors from a slate of three candidates chosen by the Washington Foundation. However, the board retains the right to veto all three candidates and force the Foundation to offer different candidates, even if the candidates meet the qualifications.

140. Premera asserts that it needs the veto in order to ensure that the Foundation member is not only qualified but also has the "right chemistry" to work with the other members of the board. In essence, Premera can nullify the Foundation's right to board representation of its choosing by rejecting qualified candidates simply because Premera does not perceive there is the "right chemistry." The stringent qualifications for nomination to the board are sufficient protection for Premera without imposing additional subjective conditions on the Foundations' right to representation.

141. Premera also has placed a limitation on Foundation board representation of five years or less than 5% ownership interest, whichever occurs first. Given the divestiture schedule, blackout periods when no shares can be sold, and other delays, the Washington Foundation could still have a material equity interest in Premera of as much as 50% of the company after five years and 20% of the company after seven years.

142. The Blackstone Group has recommended that there be a threshold of a number of shares after the five-year period below which the Foundations' ownership would have to

drop before board representation is terminated. Given the fact that there is a divestiture schedule that will compel the Foundations to reduce their interest in the company, I am persuaded that board representation should be determined by ownership interest rather than an arbitrary time limit.

143. Although Premera asserts that many of the provisions in the VTDA that are objectionable to the OIC Staff and their consultants are included because of BCBSA requirements, Premera insists that the VTDA should stay in force even if the Blue license were lost post-conversion. The consequence is that the Foundations, which may be holding a substantial interest in the company at the time the license is lost, would not be able to freely control and vote their shares as any other stockholder could in order to influence the future course of the company. Indeed, control may remain with minority interests in the company and a board and management that were at the helm when the events occurred that resulted in the loss of the license.

144. During the hearing Premera questioned whether the Foundations' boards would be up to running an insurance company if they could freely vote their shares. This is not a reasonable concern. A majority shareholders of a troubled company do not necessarily run the company; rather, they have the voting power to select individuals from within and without the company to turn the company around. The need for the VTDA to remain intact is also suspect by the fact that there was no such requirement in the WellCHOICE conversion. I am persuaded that the perpetuation of the VTDA after the loss of the Blue license serves the interests of the board and the management but not the interests of the company's subscribers and the Foundation and public shareholders.

145. Because of the voting trust, the Foundations' shares would be voted by the independent directors of the board of New PREMERA, except where the Foundations are specifically granted the right to vote some or all of their shares outside the trust. The Foundations would not be able to control how their shares are voted. It is important, therefore, that these directors be truly independent so that the value of the Foundations' interest in New PREMERA would not be prejudiced.

146. The definition of "independence" is found in Article II, Section 4(f) of the New PREMERA by-laws and provides that a director will be considered independent if the director is not employed by or has an immediate family member that is an executive officer of another company that accounts for at least 2% or $1 million, whichever is greater, of New PREMERA's consolidated gross revenues, or for which New PREMERA accounts for at least 2% or $1 million, whichever is greater, of such other company's consolidated revenues.[28] The result is that an employee of a major customer of New PREMERA, perhaps representing as much as $56 million dollars in revenue, could be considered "independent."

147. Martin Alderson-Smith of the Blackstone Group testified that the proposed 2% rule is currently the minimum qualification followed by the New York Stock Exchange. However, in light of recent financial scandals, where the independence of boards has been questioned, many companies are adopting more stringent qualifications. Mr. Alderson-Smith identified the independence of the board as an important issue and recommended that

[28] In its closing brief, Premera suggested amendments to New PREMERA's by-laws and the VTDA to address the issues of independence of directors, veto of Foundation candidates to the board, divestiture allocation, and perpetuation of the VTDA if the Blue license is lost. The amendments do not withdraw the unacceptable provisions but appear to seek a compromise through revisions of the language. The taking of evidence concluded on the last day of the formal hearing. The OIC Staff, the Interveners, and their consultants are deprived of the opportunity to review and provide testimony on amendments that are submitted after the evidentiary record has been closed. Therefore, I am relying on the language in the documents and the testimony given as of the last day of the hearing in my decision on these issues.

qualifications for independence be revised to provide that the standard be the lesser of 2% or $1 million. I am persuaded that it is in the interest of protecting the Foundations' ownership value and in the interest of the public shareholders that the qualifications for independent directors should be more restrictive than what is currently adopted in the proposed by-laws.

148. Premera has one year to complete the IPO but has reserved to its own discretion two automatic three-month extensions. While the one year is standard for this type of transaction, the automatic extensions are not, as testified to by Mr. Koplovitz of the Blackstone Group. The longer it takes to complete the IPO the greater likelihood that there will be a material change in circumstances that could affect the value of the Foundations' interests. If an extension were warranted, it should be taken either with the agreement of the Foundations and Premera or with my approval.

149. As testified to by the OIC Staff's investment banking experts from the Blackstone Group, Mr. Koplovitz and Mr. Alderson-Smith, Premera's plan for conversion will not transfer to the Foundations the fair market value of Premera's assets.

150. Because of the various deficiencies in Premera's plan for conversion, the Blackstone Group is unable to opine that the plan, taken as a whole, is fair to the public from a financial point of view.

151. I am persuaded that the weight of the evidence supports the finding that Premera's plan for conversion does not convey fair market value, is not fair and reasonable to the public, and is not in the public interest.

152. The failure of Premera to transfer fair market value would undermine any possible mitigation that the creation of a Washington Foundation could have on the hazardous

and prejudicial effects of the conversion on subscribers, the insurance-buying public, and the public in general.

G. Review of Tax Issues

153. PWC's Report on Tax Matters, which I find credible and accept, states that Premera has obtained a draft short form tax opinion from Ernst & Young as to whether the proposed transaction constitutes a "material change" for purposes of application of Section 833 of the Internal Revenue Code. That draft short form tax opinion has not been admitted in this proceeding.

154. Mr. Ashley, the person at PWC who prepared the Tax Reports, whose testimony I find credible and accept, testified that the Internal Revenue Service informally opined that the proposed transaction would constitute a "material change" sufficient to cause Premera to lose the Section 833(b) special deduction. Mr. Ashley also testified that loss of the special deduction would result in a 15% increase of Premera's tax rate and corollary loss to Premera's bottom line of 15%. PWC's Report Addendum advised, unless a final tax opinion was submitted, to assume that the transaction would constitute a "material change."

155. I believe that the risk of loss of the special deduction by Premera as a result of the transaction is, in light of the other risks of the transaction, unacceptable. To permit conversion in view of these risks would be unfair and unreasonable to Premera's subscribers and not in the public interest and would be hazardous and prejudicial to the insurance-buying public.

156. Premera submitted evidence, which I find credible and accept, that the transaction will qualify for tax-free treatment pursuant to Sections 351 and 368 of the Internal Revenue Code, that the distribution involved in the transaction will qualify as a tax-free

distribution pursuant to Section 355 of the Internal Revenue Code, and that the transaction should not cause Premera or New Premera to under an "ownership change" as defined in Section 382(g) of the Internal Revenue Code.

H. Review of Compensation Issues

157. The evidence submitted in this proceeding included analysis of Premera's current executive compensation practices and its plans for post-conversion compensation practices. Premera retained Towers Perrin and OIC Staff retained PriceWaterhouseCoopers ("PWC") to provide expert testimony with respect to Premera's executive compensation programs. This evidence is relevant to my consideration of whether the proposed transaction will result in executive compensation which is unfair and unreasonable to Premera's subscribers and not in the public interest or hazardous or prejudicial to the insurance-buying public.

158. PWC, whose *Executive Compensation Review* and related Addendums I find credible and accept, found that some elements of Premera's current executive compensation programs are more generous to its executives than those of comparable companies, particularly other Blue Cross/Blue Shield companies. Towers Perrin, whose evidence of Premera's executive compensation philosophy I find credible and accept, reported that Premera's executive compensation philosophy is to target base compensation at the median of Premera's peer group. Premera's executive compensation programs will continue after the conversion, as will Premera's current method of developing and implementing such programs (aside from addition of a Foundation-nominated board and committee member). After the transaction, Premera's peer group will clearly be the for-profit health insurance industry and, if the current, more generous elements of the compensation programs continue while the base

compensation target moves upward, the result may well be an overly generous executive compensation package. Therefore, I conclude that this evidence is relevant to my concerns under the governing statutes.

159. PWC analyzed Premera's rate of turnover over the period 1999-2001 utilizing only voluntary terminations and found that in aggregate it has been significantly lower than industry rates. Towers Perrin analyzed this issue utilizing both voluntary and involuntary terminations and found a higher rate of turnover. I found PWC's analysis more credible.

160. PWC found that Premera's current total direct compensation (salary, annual bonus and long-term incentives) paid to the five most highly compensated executives ("Top Five Officers") and to its Senior Vice Presidents ("SVPs") is at or above the 75th percentile. PWC also found that addition of the supplemental executive retirement benefits ("SERP") to total direct compensation results in total compensation significantly above the third quartile of market practice. While PWC acknowledged that such above-market practice might be justified by a company's performance, PWC also found that Premera's relative performance score was between the 38th and 65th percentile with respect to net written premium growth, operating income, and operating margin. PWC concluded that the compensation for Premera's Top Five Officers is higher than the relative performance of the company warranted.

161. PWC made direct comparisons of Premera's executive pay practices with the practices of three groups of companies – Blue Cross/Blue Shield, health insurance, and for profit public companies. Towers Perrin used a blend of Blue Cross/Blue Shield and other public companies and then compared the blend to Premera's pay practices. PWC performed its own analysis of the executive compensation plans while Towers Perrin relied in part on

work already performed by Watson Wyatt and Mercer Consulting. I found PWC's analysis more credible.

162. PWC found that Premera's Long Term Incentive Plan ("LTIP") for its Top Five Officers and SVPs is based on the participant's base salary at the end of the plan cycle rather than at the time of the award. PWC concluded that Premera's LTIP for its Top Five Officers and SVPs is above market in that respect.

163. PWC found that minimum payments under Premera's LTIP and Annual Incentive Plans are triggered by performance goals which are approximately 50% of target and are understated in comparison to historical, actual performance. PWC also found that those plans have no requirement post-conversion of minimum shareholder return before payment is triggered and that 40% of the annual LTIP award is made on the basis of non-financial performance criteria. PWC concluded that these plans are above market in those respects.

164. PWC found that Premera's DB ("Defined Benefit") Supplemental Executive Retirement Plan ("SERP") is calculated on the basis of the executive's Final Compensation, which includes severance benefits. This plan also credits participants over 45 at hire with up to eight years of credit and no offset for other retirement benefits. PWC concluded that Premera's DB SERP is above market in those respects.

165. PWC found that there are no corresponding offsets for Premera's contributions to the supplemental retirement benefits provided to the Top Five Officers and the SVPs within qualified and non-qualified plans. PWC concluded that those benefits are above market in that respect.

166. PWC found that Premera's Change in Control ("CIC") Policy provides "walk-away rights"[29] to all Top Five Officers and SVPs rather than to just the Chief Executive Officer. PWC found that Premera's CIC Policy protects a prorated portion of an executive's annual and LTI payment in the event of a CIC. PWC concluded that the CIC Policy was above market in those respects among for-profit stock companies.

167. PWC found that Premera's CIC benefits are unusual in that they are provided via company policy rather than through individual agreements with particular executives.

168. PWC found that Premera's 40% match on executives' mandatory compensation deferrals is high compared to market practices.

169. PWC found that Premera's plan to continue its LTIP after conversion, along with the equity (stock) incentive plan, is atypical.

170. PWC found that the base salaries of Premera's executives had increased at a rate that was higher than the market, although their current level was comparable to the market. PWC found that, because the rest of the executive compensation plans are calculated on the base salary, if the past rate of increase continued, executive compensation would come to greatly exceed the market.

171. Towers Perrin's analyses focused on Premera's compensation philosophy and emphasized reliance on the compensation committee as a mechanism for ensuring appropriate executive compensation. Towers Perrin found Premera's philosophy reasonable and the compensation committee mechanism appropriate. I did not find such vague assurances helpful in light of the past practices of awarding above market compensation.

[29] "Walk away rights" are the right to terminate employment for any reason during the 30 days following the one year anniversary of a change in control event and collect 50% of the original Change in Control benefit.

172. Premera offered some compensation assurances in its amended Form A by establishing a peer group of companies as a guide for setting compensation and by allowing a Foundation board member to participate on the compensation committee. However, to the extent the assurances could moderate compensation, they only last for two years.

I. Review of Allocation Issues

173. Because the Form A is disapproved, it is not necessary to make any findings regarding the proper allocation of New PREMERA shares between the Alaska and the Washington Foundations.

J. Conditions

174. The Holding Company Act permits me to "condition approval of an acquisition on the removal of the basis of disapproval within a specified period of time." RCW 48.31C.030(5)(c). The imposition of conditions in this case cannot adequately remedy the bases of disapproval.

175. The likely affect on premiums in the individual and small group markets in Eastern Washington is an inherent by-product of Premera's ability and eventual need to exercise market power as a for-profit insurer in order to meet investors' expectations. The likely negative impact on Eastern Washington subscribers and the insurance-buying public cannot be rectified by a condition.

176. A decrease in medical expenditures is the likely consequence of Premera having to reduce costs in order to meet investors' expectations. The likely negative impact on subscribers and the insurance-buying public cannot be rectified by a condition.

177. Throughout the review of the Form A, the OIC Staff and their consultants tried to elicit from Premera specific plans for the use of the capital to be raised. Premera would only

articulate the general goal of achieving "strategic flexibility" by increasing RBC and having access to capital for improvements in service and products. Premera has failed to offer any meaningful information about its need to raise $100 to $150 million at the IPO and how the capital will be used. The OIC Staff consultants have opined that Premera's plan to raise substantial equity capital, at considerable expense, and decide later how it will be used is significantly dilutive to the value to be realized by the Foundations and therefore is not fair to the public. This deficiency in Premera's plan for conversion is so fundamental and has deprived me of a full review of the impact of the transaction that it cannot be rectified by a condition.

178. Premera has placed numerous restrictions on the Foundations' ability to control and trade their shares of stock, many of which Premera has stated are required by the BCBSA in order for Premera to maintain its license. As I have explained in this Final Order, some of these restrictions are unfair and unreasonable and result in the Foundations not receiving the fair market value of Premera's assets. I am not bound by the purported restrictions of the BCBSA. I must look at the transaction as a whole and disapprove it if it does not meet the standards of the Holding Company Act, which I have done. Because loss of the Blue license would not be in the interest of the subscribers, the insurance-buying public, or the general public, imposing conditions that will simply substitute one set of problems for another is pointless.

IV. CONCLUSIONS OF LAW

1. The scope of my authority as Washington State Insurance Commissioner to protect the public interest in matters related to insurance in this state is broad. *See, e.g., National Federation of Retired Persons v. Insurance Commissioner*, 120 Wn.2d 101, 109, 838

P.2d 680, 684 (1992); *Federated Am .Ins. Co. v. Marquardt*, 108 Wn.2d.651, 654, 741 P.2d 18, 20 (1987).

2. Where a nonprofit insurer proposes to convert to a for-profit company, as does Premera in the first such proposal in this state, I interpret Chapters 48.31B and 48.31C RCW as having been adopted by the Legislature to protect the interests of Premera's subscribers, the insurance-buying public, and the general public.

3. My obligation as Insurance Commissioner in reviewing a transaction under the Holding Company Act is to prevent harm to subscribers, the insurance-buying public, and the general public. I would be remiss in that obligation if I waited until the harm occurred and then tried to repair it, at a time that may be too late to fully protect their interests. *See Blue Cross & Blue Shield of Kansas, Inc. v. Praeger*, 276 Kan. 232, 260, 75 P.3d 226, 245 (2003).

4. The antitrust inquiry in RCW 48.31C.030(5)(a)(ii)(B) ("subsection B") is independent of other bases of disapproval set forth in RCW 48.31C.030(5)(a)(ii)(C) ("subsection C"). *See also* RCW 48.31B.015(4)(a)(ii)(B) and (C). The most reasonable interpretation of subsections B and C is that they have the same free-standing weight and that the bases of disapproval in subsection C are not dependent on the antitrust inquiry in subsection B. The contrary interpretation offered by Premera makes no sense. For example, a commissioner would be compelled to approve a Form A if there were no antitrust violation, even if the financial condition of the company was in jeopardy or the management was incompetent or inexperienced. The Legislature could not have intended and the law should not be interpreted to lead to such absurd results.

5. The terms of the Form A and representations made to me and the Attorney General, Premera's and its parent's articles of incorporation, the Washington nonprofit

corporation law (RCW 24.03.225, RCW 24.03.230, RCW 24.06.265), and the Holding Company Act (RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.030; RCW 48.31C.050) each independently and in combination require that the fair market value of New PREMERA be transferred to the Washington and Alaska Foundations.

6. After weighing all of the evidence, I have affirmatively found the following listed bases for disapproving Premera's Form A. Each conclusion reached is an independent basis for disapproving Premera's Form A.

7. Because premiums in the individual and small group markets will likely increase in the Eastern Washington counties in which Premera has market power as a consequence of Premera converting to a for-profit company, Premera's plan for conversion is unfair and unreasonable to subscribers and not in the public interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II).

8. Because premiums in the individual and small group markets will likely increase in the Eastern Washington counties in which Premera has market power as a consequence of Premera converting to a for-profit company, Premera's plan for conversion is likely to be hazardous or prejudicial to the insurance-buying public. RCW 48.31B.015(4)(a)(vi); RCW 48.31C.030(5)(a)(ii)(C)(IV).

9. Because Premera's medical loss ratio will likely decrease as a consequence of Premera converting to a for-profit company, Premera's plan for conversion is unfair and unreasonable to subscribers and not in the public interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II).

10. Because Premera's medical loss ratio will likely decrease as a consequence of Premera converting to a for-profit company, Premera's plan for conversion is likely to be

hazardous or prejudicial to the insurance-buying public. RCW 48.31B.015(4)(a)(vi); RCW 48.31C.030(5)(a)(ii)(C)(IV).

11. The likelihood of increase in premiums and decrease in medical loss ratio, as a consequence of Premera converting to a for-profit company, is exacerbated by the likely loss of the Section 833(b) special tax deduction, increase in Alaska premium tax, increased annual expenses of operating as a public company, and tendency for above market compensation packages; and, therefore, Premera's plan for conversion is unfair and unreasonable to subscribers and not in the public interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II).

12. The likelihood of increase in premiums and decrease in medical loss ratio, as a consequence of Premera converting to a for-profit company, is exacerbated by the likely loss of the Section 833(b) special tax deduction, increase in Alaska premium tax, increased annual expenses of operating as a public company, and tendency for above market compensation packages; and, therefore, Premera's plan for conversion is likely to be hazardous or prejudicial to the insurance-buying public. RCW 48.31B.015(4)(a)(vi); RCW 48.31C.030(5)(a)(ii)(C)(IV).

13. Because Premera is not transferring the fair market value of the assets of New PREMERA, its plan for conversion does not comply with either the terms of the Form A and representations made to me and the Attorney General, Premera's and its parent's articles of incorporation, the Washington nonprofit corporation law (RCW 24.03.225, RCW 24.03.230, RCW 24.06.265), or the Holding Company Act (RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.030; RCW 48.31C.050).

14. Because Premera's plan for conversion does not transfer the fair market value of the assets of New PREMERA, it is not fair and reasonable to the public and not in the public

interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.030; RCW 48.31C.050.

15. Because Premera's plan for conversion significantly dilutes the value of the Foundations' shares in New PREMERA, it is not fair and reasonable to the public and not in the public interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.030; RCW 48.31C.050.

16. Because of the restrictions, both individually and in combination, placed on the Washington Foundation's ability to control and trade the stock in New PREMERA and to represent its interests on significant matters (as more fully described in Section F of the Findings of Fact), Premera's plan for conversion is not fair and reasonable to the public and not in the public interest. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.030; RCW 48.31C.050.

17. Considering Premera's plan as a whole, it is unfair and unreasonable to subscribers, not in the public interest, and likely to be hazardous or prejudicial to the insurance-buying public. RCW 48.31B.015(4)(a)(iv); RCW 48.31C.030(5)(a)(ii)(C)(II); RCW 48.31B.015(4)(a)(vi); RCW 48.31C.030(5)(a)(ii)(C)(IV); RCW 48.31B.030; RCW 48.31C.050.

FINAL ORDER

IT IS THEREFORE ORDERED, this 15th day of July, 2004, that,

Premera's Form A request to reorganize, including converting from nonprofit to for-profit status, is hereby **DENIED**.

Mike Kreidler

MIKE KREIDLER
INSURANCE COMMISSIONER

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates	Docket No. G02-45 ATTACHMENT A TO FINAL ORDER

REVISED CODE OF WASHINGTON

Attached and incorporated herein are the following cites of RCW:

RCW 48.31B.015
Control of insurer -- Acquisition, merger, or exchange – Preacquisition notification -- Jurisdiction of courts.

RCW 48.31B.030
Insurer subject to registration -- Standards for transactions within a holding company system -- Extraordinary dividends or distributions -- Insurer's surplus.

RCW 48.31C.030
Acquisition of a domestic health carrier -- Filing -- Review--Jurisdiction of courts.

RCW 48.31C.050
Health carrier subject to registration -- Standards for transactions within a holding company system -- Notice to commissioner -- Review.

RCW 24.03.225
Distribution of assets.

RCW 24.03.230
Plan of distribution.

RCW 24.06.265
Distribution of assets.

RCW 48.31B.015

Control of insurer –
Acquisition, merger, or exchange –
Preacquisition notification –
Jurisdiction of courts.

(1) No person other than the issuer may make a tender offer for or a request or invitation for tenders of, or enter into an agreement to exchange securities of, seek to acquire, or acquire, in the open market or otherwise, voting security of a domestic insurer if, after the consummation thereof, the person would, directly or indirectly, or by conversion or by exercise of a right to acquire, be in control of the insurer. No person may enter into an agreement to merge with or otherwise to acquire control of a domestic insurer or person controlling a domestic insurer unless, at the time the offer, request, or invitation is made or the agreement is entered into, or before the acquisition of the securities if no offer or agreement is involved, the person has filed with the commissioner and has sent to the insurer, a statement containing the information required by this section and the offer, request, invitation, agreement, or acquisition has been approved by the commissioner as prescribed in this section.

For purposes of this section a domestic insurer includes a person controlling a domestic insurer unless the person, as determined by the commissioner, is either directly or through its affiliates primarily engaged in business other than the business of insurance. However, the person shall file a preacquisition notification with the commissioner containing the information set forth in RCW 48.31B.020(3)(a) sixty days before the proposed effective date of the acquisition. Persons who fail to file the required preacquisition notification with the commissioner are subject to the penalties in RCW 48.31B.020(5)(c). For the purposes of this section, "person" does not include a securities broker holding, in usual and customary broker's function, less than twenty percent of the voting securities of an insurance company or of a person who controls an insurance company.

(2) The statement to be filed with the commissioner under this section must be made under oath or affirmation and must contain the following information:

(a) The name and address of each person by whom or on whose behalf the merger or other acquisition of control referred to in subsection (1) of this section is to be effected, hereinafter called "acquiring party," and:

(i) If that person is an individual, his or her principal occupation and all offices and positions held during the past five years, and any conviction of crimes other than minor traffic violations during the past ten years;

(ii) If that person is not an individual, a report of the nature of its business operations during the past five years or for such lesser period as the person and any predecessors have been in existence; an informative description of the business intended to be done by the person's subsidiaries; any convictions of crimes during the past ten years; and a list of all individuals who are or who have been selected to become directors or executive officers of the person, or who perform or will perform functions appropriate to those positions. The list must include for each such individual the information required by (a)(i) of this subsection.

(b) The source, nature, and amount of the consideration used or to be used in effecting the merger or other acquisition of control, a description of any transaction in which funds were or are to be obtained for any such purpose, including a pledge of the insurer's stock, or the stock of any of its subsidiaries or controlling affiliates, and the identity of persons furnishing the consideration. However, where a source of the consideration is a loan made in the lender's ordinary course of business, the identity of the lender must remain confidential if the person filing the statement so requests.

(c) Fully audited financial information as to the earnings and financial condition of each acquiring party for the preceding five fiscal years of each acquiring party, or for such lesser period as the acquiring party and any predecessors have been in existence, and similar unaudited information as of a date not earlier than ninety days before the filing of the statement.

(d) Any plans or proposals that each acquiring party may have to liquidate the insurer, to sell its assets or merge or consolidate it with any person, or to make any other material change in its business or corporate structure or management.

(e) The number of shares of any security referred to in subsection (1) of this section that each acquiring party proposes to acquire, the terms of the offer, request, invitation, agreement, or acquisition referred to in subsection (1) of this section, and a statement as to the method by which the fairness of the proposal was arrived at.

(f) The amount of each class of any security referred to in subsection (1) of this section that is beneficially owned or concerning which there is a right to acquire beneficial ownership by each acquiring party.

(g) A full description of any contracts, arrangements, or understandings with respect to any security referred to in subsection (1) of this section in which an acquiring party is involved, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guarantees of loans, guarantees against loss or guarantees of profits, division of losses or profits, or the giving or withholding of proxies. The description must identify the persons with whom the contracts, arrangements, or understandings have been entered into.

(h) A description of the purchase of any security referred to in subsection (1) of this section during the twelve calendar months before the filing of the statement, by an acquiring party, including the dates of purchase, names of the purchasers, and consideration paid or agreed to be paid for the security.

(i) A description of any recommendations to purchase any security referred to in subsection (1) of this section made during the twelve calendar months before the filing of the statement, by an acquiring party, or by anyone based upon interviews or at the suggestion of the acquiring party.

(j) Copies of all tender offers for, requests or invitations for tenders of, exchange offers for, and agreements to acquire or exchange any securities referred to in subsection (1) of this section, and, if distributed, of additional soliciting material relating to the securities.

(k) The term of an agreement, contract, or understanding made with or proposed to be made with a broker-dealer as to solicitation or securities referred to in subsection (1) of this section for tender, and the amount of fees, commissions, or other compensation to be paid to broker-dealers with regard to the securities.

(l) Such additional information as the commissioner may prescribe by rule as necessary or appropriate for the protection of policyholders of the insurer or in the public interest.

If the person required to file the statement referred to in subsection (1) of this section is a partnership, limited partnership, syndicate, or other group, the commissioner may require that the information called for by (a) through (l) of this subsection shall be given with respect to each partner of the partnership or limited partnership, each member of the syndicate or group, and each person who controls a partner or member. If a partner, member, or person is a corporation, or the person required to file the statement referred to in subsection (1) of this section is a corporation, the commissioner may require that the information called for by (a) through (l) of this subsection shall be given with respect to the corporation, each officer and director of the corporation, and each person who is directly or indirectly the beneficial owner of more than ten percent of the outstanding voting securities of the corporation.

If a material change occurs in the facts set forth in the statement filed with the commissioner and sent to the insurer under this section, an amendment setting forth the change, together with copies of all documents and other material relevant to the change, must be filed with the commissioner and sent to the insurer within two business days after the person learns of the change.

(3) If an offer, request, invitation, agreement, or acquisition referred to in subsection (1) of this section is proposed to be made by means of a registration statement under the Securities Act of 1933 or in circumstances requiring the disclosure of similar information under the Securities Exchange Act of 1934, or under a state law requiring similar registration or disclosure, the person required to file the statement referred to in subsection (1) of this section may use those documents in furnishing the information called for by that statement.

(4)(a) The commissioner shall approve a merger or other acquisition of control referred to in subsection (1) of this section unless, after a public hearing thereon, he or she finds that:

(i) After the change of control, the domestic insurer referred to in subsection (1) of this section would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed;

(ii) The effect of the merger or other acquisition of control would be substantially to lessen competition in insurance in this state or tend to create a monopoly therein. In applying the competitive standard in (a)(ii) of this subsection:

(A) The informational requirements of RCW 48.31B.020(3)(a) and the standards of RCW 48.31B.020(4)(b) apply;

(B) The commissioner may not disapprove the merger or other acquisition if the commissioner finds that any of the situations meeting the criteria provided by RCW 48.31B.020(4)(c) exist; and

(C) The commissioner may condition the approval of the merger or other acquisition on the removal of the basis of disapproval within a specified period of time;

(iii) The financial condition of an acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders;

(iv) The plans or proposals that the acquiring party has to liquidate the insurer, sell its assets, consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest;

(v) The competence, experience, and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or

(vi) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

(b) The commissioner shall approve an exchange or other acquisition of control referred to in this section within sixty days after he or she declares the statement filed under this section to be complete and after holding a public hearing. At the hearing, the person filing the statement, the insurer, and any person whose significant interest is determined by the commissioner to be affected may present evidence, examine and cross-examine witnesses, and offer oral and written arguments and in connection therewith may conduct discovery proceedings in the same manner as is allowed in the superior court of this state. All discovery proceedings must be concluded not later than three days before the commencement of the public hearing.

(c) The commissioner may retain at the acquiring person's expense any attorneys, actuaries, accountants, and other experts not otherwise a part of the commissioner's staff as may be reasonably necessary to assist the commissioner in reviewing the proposed acquisition of control. All reasonable costs of a hearing held under this section, as determined by the commissioner, including costs associated with the commissioner's use of investigatory, professional, and other necessary personnel, mailing of required notices and other information, and use of equipment or facilities, must be paid before issuance of the commissioner's order by the acquiring person.

(5) This section does not apply to:

(a) A transaction that is subject to RCW 48.31.010, dealing with the merger or consolidation of two or more insurers;

(b) An offer, request, invitation, agreement, or acquisition that the commissioner by order has exempted from this section as: (i) Not having been made or entered into for the purpose and not having the effect of changing or influencing the control of a domestic insurer, or (ii) otherwise not comprehended within the purposes of this section.

(6) The following are violations of this section:

(a) The failure to file a statement, amendment, or other material required to be filed under subsection (1) or (2) of this section; or

(b) The effectuation or an attempt to effectuate an acquisition of control of, or merger with, a domestic insurer unless the commissioner has given approval thereto.

(7) The courts of this state have jurisdiction over every person not resident, domiciled, or authorized to do business in this state who files a statement with the commissioner under this section, and over all actions involving that person arising out of violations of this section, and each such person is deemed to have performed acts equivalent to and constituting an appointment by that person of the commissioner to be the person's true and lawful attorney upon whom may be served all lawful process in an action, suit, or proceeding arising out of violations of this section. Copies of all such lawful process shall be served on the commissioner and transmitted by registered or certified mail by the commissioner to such person at the person's last known address.

[1993 c 462 § 4.]

RCW 48.31B.030
Insurer subject to registration –
Standards for transactions within a holding company system –
Extraordinary dividends or distributions –
Insurer's surplus.

(1)(a) Transactions within a holding company system to which an insurer subject to registration is a party are subject to the following standards:

(i) The terms must be fair and reasonable;

(ii) Charges or fees for services performed must be fair and reasonable;

(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied;

(iv) The books, accounts, and records of each party to all such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties; and

(v) The insurer's surplus regarding policyholders after dividends or distributions to shareholders or affiliates must be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs.

(b) The following transactions involving a domestic insurer and a person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into the transaction and the commissioner declares the notice to be sufficient at least sixty days before, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period:

(i) Sales, purchases, exchanges, loans or extensions of credit, guarantees, or investments if the transactions are equal to or exceed: (A) With respect to nonlife insurers, the lesser of three percent of the insurer's admitted assets or twenty-five percent of surplus as regards policyholders; (B) with respect to life insurers, three percent of the insurer's admitted assets; each as of the 31st day of the previous December;

(ii) Loans or extensions of credit to any person who is not an affiliate, where the insurer makes the loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, an affiliate of the insurer making the loans or extensions of credit if the transactions are equal to or exceed: (A) With respect to nonlife insurers, the lesser of three percent of the insurer's admitted assets or twenty-five percent of surplus as regards policyholders; (B) with respect to life insurers, three percent of the insurer's admitted assets; each as of the 31st day of the previous December;

(iii) Reinsurance agreements or modifications to them in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of the previous December, including those agreements that may require as consideration the transfer of assets from an insurer to a nonaffiliate, if an agreement or understanding exists between the insurer and nonaffiliate that any portion of the assets will be transferred to one or more affiliates of the insurer;

(iv) Management agreements, service contracts, and cost-sharing arrangements; and

(v) Material transactions, specified by rule, that the commissioner determines may adversely affect the interests of the insurer's policyholders.

Nothing contained in this section authorizes or permits a transaction that, in the case of an insurer not a member of the same holding company system, would be otherwise contrary to law.

(c) A domestic insurer may not enter into transactions that are part of a plan or series of like transactions with persons within the holding company system if the purpose of those separate transactions is to avoid the statutory threshold amount and thus avoid the review that would occur otherwise. If the commissioner determines that the separate transactions were entered into over a twelve-month period for that purpose, the commissioner may apply for an order as described in RCW 48.31B.045(1).

(d) The commissioner, in reviewing transactions under (b) of this subsection, shall consider whether the transactions comply with the standards set forth in (a) of this subsection and whether they may adversely affect the interests of policyholders.

(e) The commissioner shall be notified within thirty days of an investment of the domestic insurer in any one corporation if the total investment in the corporation by the insurance holding company system exceeds ten percent of the corporation's voting securities.

(2)(a) No domestic insurer may pay an extraordinary dividend or make any other extraordinary distribution to its shareholders until: (i) Thirty days after the commissioner declares that he or she has received sufficient notice of the declaration thereof and has not within that period disapproved the payment; or (ii) the commissioner has approved the payment within the thirty-day period.

(b) For purposes of this section, an extraordinary dividend or distribution is a dividend or distribution of cash or other property whose fair market value, together with that of other dividends or distributions made within the period of twelve consecutive months ending on the date on which the proposed dividend is scheduled for payment or distribution, exceeds the greater of: (i) Ten percent of the company's surplus as regards policyholders as of the 31st day of the previous December; or (ii) the net gain from operations of the company if the company is a life insurance company, or the net income if the company is not a life insurance company, for the twelve month period ending the 31st day of the previous December, but does not include pro rata distributions of any class of the company's own securities.

(c) Notwithstanding any other provision of law, an insurer may declare an extraordinary dividend or distribution that is conditional upon the commissioner's approval. The declaration confers no rights upon shareholders until: (i) The commissioner has approved the payment of the dividend or distribution; or (ii) the commissioner has not disapproved the payment within the thirty-day period referred to in (a) of this subsection.

(3) For purposes of this chapter, in determining whether an insurer's surplus as regards policyholders is reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs, the following factors, among others, may be considered:

(a) The size of the insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria;

(b) The extent to which the insurer's business is diversified among the several lines of insurance;

(c) The number and size of risks insured in each line of business;

(d) The extent of the geographical dispersion of the insurer's insured risks;

(e) The nature and extent of the insurer's reinsurance program;

(f) The quality, diversification, and liquidity of the insurer's investment portfolio;

(g) The recent past and projected future trend in the size of the insurer's surplus as regards policyholders;

(h) The surplus as regards policyholders maintained by other comparable insurers;

(i) The adequacy of the insurer's reserves;

(j) The quality and liquidity of investments in affiliates. The commissioner may discount any such investment or may treat any such investment as a disallowed asset for purposes of determining the adequacy of surplus as regards policyholders whenever in his or her judgment the investment so warrants; and

(k) The quality of the insurer's earnings and the extent to which the reported earnings include extraordinary items.

[1993 c 462 § 7.]

RCW 48.31C.030
Acquisition of a domestic health carrier –
Filing –
Review—
Jurisdiction of courts.

(1) No person may acquire control of a domestic health carrier unless the person has filed with the commissioner and has sent to the health carrier a statement containing the information required by this section and the acquisition has been approved by the commissioner as prescribed in this section.

(2) The statement to be filed with the commissioner under this section must be made under oath or affirmation and must contain the following information:

(a) The name and address of the acquiring party. For purposes of this section, "acquiring party" means each person by whom or on whose behalf the acquisition of control under subsection (1) of this section is to be effected:

(i) If the acquiring party is an individual, his or her principal occupation and all offices and positions held during the past five years, and any conviction of crimes other than minor traffic violations during the past ten years;

(ii) If the acquiring party is not an individual, a report of the nature of its business operations during the past five years or for such lesser period as the person and any predecessors have been in existence; an informative description of the business intended to be done by the person's subsidiaries; any convictions of crimes during the past ten years; and a list of all individuals who are or who have been selected to become directors, trustees, or executive officers of the person, or who perform or will perform functions appropriate to those positions. The list must include for each such individual the information required by (a)(i) of this subsection.

(b) The source, nature, and amount of the consideration used or to be used in effecting the acquisition of control, a description of any transaction in which funds were or are to be obtained for any such purpose, including a pledge of assets, a pledge of the health carrier's stock, or the stock of any of its subsidiaries or controlling affiliates, and the identity of persons furnishing the consideration. However, where a source of the consideration is a loan made in the lender's ordinary course of business, the identity of the lender must remain confidential if the person filing the statement so requests.

(c) Fully audited financial information as to the earnings and financial condition of each acquiring party for the preceding five fiscal years of each acquiring party, or for such lesser period as the acquiring party and any predecessors have been in existence, and similar unaudited information as of a date not earlier than ninety days before the filing of the statement. If the acquiring party and any predecessor has not had fully audited financial statements prepared during any of the preceding five years, then reviewed financial statements may be substituted for those years, except for the latest fiscal year which must be fully audited financial statements.

(d) Any plans or proposals that each acquiring party may have to liquidate the health carrier, to sell its assets or merge or consolidate it with any person, or to make any other material change in its business or corporate structure or management.

(e) The number of shares of any security or number and description of other voting rights referred to in RCW 48.31C.010(3) that each acquiring party proposes to acquire, the terms of the offer, request, invitation, agreement, or acquisition under RCW 48.31C.010(3), and a statement as to the method by which the fairness of the proposal was arrived at.

(f) The amount of each class of any security referred to in RCW 48.31C.010(3) that is beneficially owned or concerning which there is a right to acquire beneficial ownership by each acquiring party.

(g) A full description of any contracts, arrangements, or understandings with respect to any security referred to in RCW 48.31C.010(3) in which an acquiring party is involved, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guarantees of loans, guarantees against loss or guarantees of profits, division of losses or profits, or the giving or withholding of proxies. The description must identify the persons with whom the contracts, arrangements, or understandings have been entered into.

(h) A description of the purchase of any security referred to in RCW 48.31C.010(3) during the twelve calendar months before the filing of the statement, by an acquiring party, including the dates of purchase, names of the purchasers, and consideration paid or agreed to be paid for the security.

(i) A description of any recommendations to purchase any security referred to in RCW 48.31C.010(3) made during the twelve calendar months before the filing of the statement, by an acquiring party, or by anyone based upon interviews with outside parties or at the suggestion of the acquiring party.

(j) Copies of all tender offers for, requests or invitations for tenders of, exchange offers for, and agreements to acquire or exchange any securities referred to in RCW 48.31C.010(3), and, if distributed, of additional soliciting material relating to the securities.

(k) The term of an agreement, contract, or understanding made with or proposed to be made with a broker-dealer as to solicitation or securities referred to in RCW 48.31C.010(3) for tender, and the amount of fees, commissions, or other compensation to be paid to broker-dealers with regard to the securities.

(l) Such additional information as the commissioner may prescribe by rule as necessary or appropriate for the protection of subscribers of the health carrier or in the public interest.

If the person required to file the statement referred to in subsection (1) of this section is a partnership, limited partnership, syndicate, or other group, the commissioner may require that the information required under (a) through (l) of this subsection must be given with respect to each partner of the partnership or limited partnership, each member of the syndicate or group, and each person who controls a partner or member. If a partner, member, or person is a corporation, or the person required to file the statement referred to in subsection (1) of this section is a corporation, the commissioner may require that the information required under (a) through (l) of this subsection must be given with respect to the corporation, each officer and director of the corporation, and each person who is directly or indirectly the beneficial owner of more than ten percent of the outstanding voting securities of the corporation.

If a material change occurs in the facts set forth in the statement filed with the commissioner and sent to the health carrier under this section, an amendment setting forth the change, together with copies of all documents and other material relevant to the change, must be filed with the commissioner and sent to the health carrier within two business days after the person learns of the change.

(3) If an offer, request, invitation, agreement, or acquisition referred to in subsection (1) of this section is proposed to be made by means of a registration statement under the Securities Act of 1933 or in circumstances requiring the disclosure of similar information under the Securities Exchange Act of 1934, or under a state law requiring similar registration or disclosure, the person required to file the statement referred to in subsection (1) of this section may use those documents in furnishing the information called for by that statement.

(4) The commissioner shall approve an exchange or other acquisition of control referred to in this section within sixty days after he or she declares the statement filed under this section to be complete and if a hearing is requested by the commissioner or either party to the transaction, after holding a public hearing. Unless the commissioner declares the statement to be incomplete and requests additional information, the statement is deemed complete sixty days after receipt of the statement by the commissioner. If the commissioner declares the statement to be incomplete and requests additional information, the sixty-day time period in which the statement is deemed complete shall be tolled until fifteen days after receipt by the commissioner of the additional information. If the commissioner declares the statement to be incomplete, the commissioner shall promptly notify the person filing the statement of the filing deficiencies and shall set forth with specificity the additional information required to make the

filing complete. At the hearing, the person filing the statement, the health carrier, and any person whose significant interest is determined by the commissioner to be affected may present evidence, examine and cross-examine witnesses, and offer oral and written arguments, and in connection therewith may conduct discovery proceedings in the same manner as is allowed in the superior court of this state. All discovery proceedings must be concluded not later than three business days before the commencement of the public hearing.

(5)(a) The commissioner shall approve an acquisition of control referred to in subsection (1) of this section unless, after a public hearing, he or she finds that:

(i) After the change of control, the domestic health carrier referred to in subsection (1) of this section would not be able to satisfy the requirements for registration as a health carrier;

(ii) The antitrust section of the office of the attorney general and any federal antitrust enforcement agency has chosen not to undertake a review of the proposed acquisition and the commissioner pursuant to his or her own review finds that there is substantial evidence that the effect of the acquisition may substantially lessen competition or tend to create a monopoly in the health coverage business.

If the antitrust section of the office of the attorney general does not undertake a review of the proposed acquisition and the review is being conducted by the commissioner, then the commissioner shall seek input from the attorney general throughout the review.

If the antitrust section of the office of the attorney general undertakes a review of the proposed transaction then the attorney general shall seek input from the commissioner throughout the review. As to the commissioner, in making this determination:

(A) The informational requirements of RCW 48.31C.020(1)(a) apply;

(B) The commissioner may not disapprove the acquisition if the commissioner finds that:

(I) The acquisition will yield substantial economies of scale or economies in resource use that cannot be feasibly achieved in any other way, and the public benefits that would arise from the economies exceed the public benefits that would arise from more competition; or

(II) The acquisition will substantially increase or will prevent significant deterioration in the availability of health care coverage, and the public benefits of the increase exceed the public benefits that would arise from more competition;

(C) The commissioner may condition the approval of the acquisition on the removal of the basis of disapproval, as follows, within a specified period of time:

(I) The financial condition of an acquiring party is such as might jeopardize the financial stability of the health carrier, or prejudice the interest of its subscribers;

(II) The plans or proposals that the acquiring party has to liquidate the health carrier, sell its assets, consolidate or merge it with any person, or to make any other material change in its

business or corporate structure or management, are unfair and unreasonable to subscribers of the health carrier and not in the public interest;

(III) The competence, experience, and integrity of those persons who would control the operation of the health carrier are such that it would not be in the interest of subscribers of the health carrier and of the public to permit the merger or other acquisition of control; or

(IV) The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

(b) The commissioner may retain at the acquiring person's expense any attorneys, actuaries, accountants, and other experts not otherwise a part of the commissioner's staff as may be reasonably necessary to assist the commissioner in reviewing the proposed acquisition of control. All reasonable costs of a hearing held under this section, as determined by the commissioner, including reasonable costs associated with the commissioner's use of investigatory, professional, and other necessary personnel, mailing of required notices and other information, and use of equipment or facilities, must be paid before issuance of the commissioner's order by the acquiring person.

(c) The commissioner may condition approval of an acquisition on the removal of the basis of disapproval within a specified period of time.

(6) Upon the request of a party to the acquisition the commissioner may order that this section does not apply to an offer, request, invitation, agreement, or acquisition as:

(a) Not having been made or entered into for the purpose and not having the effect of changing or influencing the control of a domestic health carrier; or

(b) Otherwise not comprehended within the purposes of this section.

(7) The following are violations of this section:

(a) The failure to file a statement, amendment, or other material required to be filed under subsection (1) or (2) of this section; or

(b) The effectuation or an attempt to effectuate an acquisition of control of a domestic health carrier unless the commissioner has given approval.

(8) The courts of this state have jurisdiction over every person not resident, domiciled, or authorized to do business in this state who files a statement with the commissioner under this section, and over all actions involving that person arising out of violations of this section, and such a person has performed acts equivalent to and constituting an appointment by that person of the commissioner to be the person's true and lawful attorney upon whom may be served all lawful process in an action, suit, or proceeding arising out of violations of this section. Copies of all such lawful process shall be served on the commissioner and transmitted by registered or certified mail by the commissioner to such a person at the person's last known address.

[2001 c 179 § 3.]

RCW 48.31C.050
Health carrier subject to registration –
Standards for transactions within a holding company system –
Notice to commissioner –
Review.

(1) Transactions within a health carrier holding company system to which a health carrier subject to registration is a party are subject to the following standards:

(a) The terms must be fair and reasonable;

(b) Charges or fees for services performed must be fair and reasonable;

(c) Expenses incurred and payment received must be allocated to the health carrier in conformity with customary statutory accounting practices consistently applied;

(d) The books, accounts, and records of each party to all such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties; and

(e) The health carrier's net worth after the transaction must exceed the health carrier's company action level risk-based capital. In addition, the commissioner may disapprove a transaction if the health carrier's risk-based capital net worth is less than the product of 2.5 and the health carrier's authorized control level risk-based capital and the commissioner reasonably believes that the health carrier's net worth is at risk of falling below its company action level risk-based capital due to anticipated future financial losses not reflected in the risk-based capital calculation. This subsection (1)(e) does not prohibit transactions that improve or help maintain the health carrier's net worth.

(2) The following transactions, excepting those transactions which are subject to approval by the commissioner elsewhere within this title, involving a domestic health carrier and a person in its health carrier holding company system may not be entered into unless the health carrier has notified the commissioner in writing of its intention to enter into the transaction and the commissioner does not declare the notice to be incomplete at least thirty days before, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. Unless the commissioner declares the notice to be incomplete and requests additional information, the notice is deemed complete thirty days after receipt of the notice by the commissioner. If the commissioner declares the notice to be incomplete, the thirty-day time period in which the notice is deemed complete shall be tolled until fifteen days after the receipt by the commissioner of the additional information:

(a) Sales, purchases, exchanges, loans or extensions of credit, guarantees, or investments if the transactions are equal to or exceed the lesser of (i) two months of the health carrier's annualized claims and administrative costs, (ii) five percent of the health carrier's admitted assets, or (iii) twenty-five percent of net worth, as of the 31st day of the previous December;

(b) Loans or extensions of credit to any person who is not an affiliate, if the health carrier makes the loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, an affiliate of the health carrier making the loans or extensions of credit, if the transactions are equal to or exceed the lesser of (i) two months of the health carrier's annualized claims and administrative costs, (ii) three percent of the health carrier's admitted assets, or (iii) twenty-five percent of net worth, as of the 31st day of the previous December;

(c) Reinsurance agreements or modifications to them in which the reinsurance premium or a change in the health carrier's liabilities equals or exceeds five percent of the health carrier's net worth, as of the 31st day of the previous December, including those agreements that may require as consideration the transfer of assets from a health carrier to a nonaffiliate, if an agreement or understanding exists between the health carrier and nonaffiliate that any portion of the assets will be transferred to one or more affiliates of the health carrier;

(d) Management agreements, service contracts, and cost-sharing arrangements; and

(e) Other acquisitions or dispositions of assets involving more than five percent of the health carrier's admitted assets, specified by rule, that the commissioner determines may adversely affect the interests of the health carrier's subscribers.

(3) A domestic health carrier may not enter into transactions that are part of a plan or series of like transactions with persons within the health carrier holding company system if the aggregate amount of the transactions within a twelve-month period exceed the statutory threshold amount. If the commissioner determines that the separate transactions entered into over a twelve-month period exceed the statutory threshold amount, the commissioner may apply for an order as described in RCW 48.31C.080(1).

(4) The commissioner, in reviewing transactions under subsection (2) of this section, shall consider whether the transactions comply with the standards set forth in subsection (1) of this section.

(5) If a health carrier complies with the terms of a management agreement, service contract, or cost-sharing agreement that has not been disapproved by the commissioner under subsection (2) of this section, then the health carrier is not required to obtain additional approval from the commissioner for individual transactions conducted under the terms of the management agreement, service contract, or cost-sharing agreement. The commissioner, however, retains the authority to examine the individual transactions to determine their compliance with the terms of the management agreement, service contract, or cost-sharing agreement and subsection (1) of this section.

(6) This section does not authorize or permit a transaction that, in the case of a health carrier not a member of the same health carrier holding company system, would be otherwise contrary to law.

[2001 c 179 § 5.]

RCW 24.03.225

Distribution of assets.

The assets of a corporation in the process of dissolution shall be applied and distributed as follows:

(1) All liabilities and obligations of the corporation shall be paid, satisfied and discharged, or adequate provision shall be made therefor;

(2) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements;

(3) Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this chapter;

(4) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the bylaws to the extent that the articles of incorporation or bylaws determine the distributive rights of members, or any class or classes of members, or provide for distribution to others;

(5) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or not for profit, as may be specified in a plan of distribution adopted as provided in this chapter.

[1967 c 235 § 46.]

RCW 24.03.230

Plan of distribution.

A plan providing for the distribution of assets, not inconsistent with the provisions of this chapter, may be adopted by a corporation in the process of dissolution and shall be adopted by a corporation for the purpose of authorizing any transfer or conveyance of assets for which this chapter requires a plan of distribution, in the following manner:

(1) Where there are members having voting rights, the board of directors shall adopt a resolution recommending a plan of distribution and directing the submission thereof to a vote at a meeting of members having voting rights, which may be either an annual or a special meeting. Written or printed notice setting forth the proposed plan of distribution or a summary thereof shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this chapter for the giving of notice of meetings of members. Such plan of distribution shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.

(2) Where there are no members, or no members having voting rights, a plan of distribution shall be adopted at a meeting of the board of directors upon receiving a vote of a majority of the directors in office.

If the plan of distribution includes assets received and held by the corporation subject to limitations described in subsection (3) of RCW 24.03.225, notice of the adoption of the proposed plan shall be submitted to the attorney general by registered or certified mail directed to him at his office in Olympia, at least twenty days prior to the meeting at which the proposed plan is to be adopted. No plan for the distribution of such assets may be adopted without the approval of the attorney general, or the approval of a court of competent jurisdiction in a proceeding to which the attorney general is made a party. In the event that an objection is not filed within twenty days after the date of mailing, his approval shall be deemed to have been given.

[1969 ex.s. c 115 § 3; 1967 c 235 § 47.]

RCW 24.06.265
Distribution of assets.

The assets of a corporation in the process of dissolution shall be applied and distributed as follows:

(1) All liabilities and obligations of the corporation shall be paid, satisfied and discharged, or adequate provision made therefor;

(2) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred, or conveyed in accordance with such requirements;

(3) Remaining assets, if any shall be distributed to the members, shareholders or others in accordance with the provisions of the articles of incorporation.

[1969 ex.s. c 120 § 53.]

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates	Docket No. G02-45 ATTACHMENT B TO FINAL ORDER

ATTORNEY EYES ONLY

B.1 The PWC Analysis found that Premera has projected that [**Proprietary Material Redacted**] Projected operating margins for [ ] Premera's Individual and Small Group lines will [ ] while its large group line will [ ] PWC's Analysis further found that in Eastern Washington Premera projects that [ ] while its large group Eastern Washington line will [ ]

B.2 The PWC Analysis demonstrated that, [**Proprietary Material Redacted**]

B.3 PWC's Analysis concluded that, [

Proprietary Material Redacted

Proprietary Material
Redacted

B.4 Premera did include in its projections through 2007[2] an estimate of its administrative costs,

B.5 Cantilo & Bennett's Final Report ("C&B Report") notes that Premera's board minutes and meeting statements reflect the company's intention

Proprietary Material
Redacted

B.6 The PWC Analysis found that,

Proprietary Material
Redacted

B.7 Premera's ASC business currently is

Premera projects that the ASC line will

It does not seem likely that Premera will

Premera projects that

Proprietary Material
Redacted

[1] Interestingly, there was no evidence presented of Premera's historical target margins on the individual and small group lines of business. Steven B. Larsen's Report speculates

Proprietary Material
Redacted

[2] PWC noted that Premera's projections

Proprietary Material
Redacted

Exhibit B

9-5

The Honorable Paula Casey

☐ **EXPEDITE** (if filing within 5 court days of hearing)

☒ Hearing is set:

Date: Friday, September 5, 2003

Time: 10:30 a.m.

Judge/Calendar: Honorable Paula Casey

FILED
SUPERIOR COURT
THURSTON COUNTY, WASH.
03 SEP -5 PM 1:12
BETTY J. GOULD, CLERK
BY _____ DEPUTY

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF THURSTON

PREMERA, a Washington non-profit miscellaneous corporation; and PREMERA BLUE CROSS, a Washington non-profit corporation,

Petitioners,

v.

MIKE KREIDLER, Insurance Commissioner for the State of Washington,

Respondent.

No. 03-2-00112-8

~~[PROPOSED]~~ ORDER

THIS Matter came before the Court on the Petition for Judicial Review filed by PREMERA and Premera Blue Cross (collectively, "Premera") under chapter 34.05 RCW with respect to an Order of the Insurance Commissioner of the State of Washington (the "Commissioner"). Having considered the record in this matter; Premera's Petition, Opening Brief, and supporting papers; the Commissioner's Response Brief and supporting papers; Premera's Reply Brief; Commissioners Supplemental Brief and Proposed Order and the oral argument presented by counsel for the parties,

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the Court enters its findings and conclusions, grants declaratory relief, and remands this matter to the Commissioner as follows:

I. FINDINGS AND CONCLUSIONS

Premera's Form A Statement

1. On May 30, 2002, Premera advised the Office of the Insurance Commissioner ("OIC") of its intent to reorganize Premera Blue Cross and certain of its affiliates from Washington non-profit corporations to for-profit corporations. On September 17, 2002, Premera filed a "Statement Regarding the Acquisition of Control of a Domestic Health Carrier and Domestic Insurer" ("Form A Statement"), the formal application required for approval of the reorganization. Premera supplemented the Form A Statement on September 27, 2002 and October 25, 2002.

2. The OIC administrative proceeding on Premera's Form A Statement is entitled *In the Matter of the Application regarding the Conversion and Acquisition of Control of Premera Blue Cross and its Affiliates,* Office of the Insurance Commissioner, Docket No. G02-45.

Statutes And Regulations Governing Form A Statements

3. Review and approval of the Form A Statement is governed by the criteria set forth in the Insurer Holding Company Act, chapter 48.31B RCW (the "Insurer Act") and the Holding Company Act for Health Care Service Contractors and Health Maintenance Organizations, chapter 48.31C RCW (the "Health Care Service Contractors Act") (collectively, the "Holding Company Acts").

4. The Holding Company Acts set forth in detail the information that must be provided in a Form A Statement. RCW 48.31B.015(2)(a)-(l); RCW 48.31C.030(2)(a)-(l). The OIC regulations implementing the Holding Company Acts also require that an

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applicant "shall provide the required information on Form A, hereby made a part of this regulation." WAC 284-18A-350. *See also* WAC 284-18-300. The OIC rules specify the format and detail the contents of the Form A Statement. WAC 284-18A-910; WAC 284-18-910.

5. In addition to setting forth the required content of a Form A Statement, the Holding Company Acts establish criteria for evaluating a proposed transaction. RCW 48.31B.015(4)(a); RCW 48.31C.030(5)(a).

6. The Holding Company Acts permit the Commissioner to conduct an investigation, order production of books and records, and retain experts to assist in his review and investigation of the proposed transaction detailed in a Form A Statement. RCW 48.31B.015(4)(c); RCW 48.31C.040(4)(b); RCW 48.31C.070. *See also* RCW 34.05.446; WAC 10-08-120.

7. The Holding Company Acts require the Commissioner to decide whether to "approve [the transaction] within sixty days after he or she declares the [Form A Statement] to be complete ... ." RCW 48.31B.015(4)(b); RCW 48.31C.030(4).

8. In addition, the Health Care Service Contractors Act provides in part:

> Unless the commissioner declares the [Form A Statement] to be incomplete and requests additional information, the statement is deemed complete sixty days after receipt of the statement by the commissioner. If the commissioner declares the statement to be incomplete and requests additional information, the sixty-day time period in which the statement is deemed complete shall be tolled until fifteen days after receipt by the commissioner of the additional information.

RCW 48.31C.030(4).

9. If a Form A Statement is declared incomplete, the Health Care Service Contractors Act requires that "the commissioner shall promptly notify the person filing

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the statement of the filing deficiencies and shall set forth with specificity the additional information required to make the filing complete." RCW 48.31C.030(4).

10. A hearing must be held on a Form A Statement under RCW 48.31B.015(4) and, if requested, under RCW 48.31C.030(4). Under Washington law, the record of an adjudicative proceeding consists of all evidence, the hearing and its transcript, and other submissions to the agency. RCW 34.05.476; *see also* WAC chapter 10-08.

The Commissioner's Orders

11. The Commissioner entered his First Order: Case Management Order ("First Order") on October 24, 2002. In his First Order, the Commissioner announced that an adjudicative hearing would be held as part of the OIC's consideration of the reorganization described in Premera's Form A Statement. First Order at 2.

12. The First Order provided that Premera's Form A Statement "will not be considered complete until the adjudicative hearing has concluded and the administrative record is closed." First Order at 2.

13. Premera timely sought reconsideration by the Commissioner of the First Order. *See* Premera's Motion for Partial Reconsideration and Clarification of the First Order: Case Management Order.

14. The Commissioner's Third Order: Ruling On Premera's Objections To The Case Management Order in ("Third Order") was entered on December 23, 2002. The Third Order denied Premera's motion for reconsideration of the First Order.

15. The Third Order declared that Premera's Form A Statement was not complete. Third Order at 6. The Third Order incorporated the Commissioner's earlier holding that the Form A Statement will not be considered complete until the adjudicative hearing has concluded and the administrative record has closed.

15a. In the Third Order the Commissioner announced that the Form A Statement was incomplete because OIC data requests had not been fully complied with. No specifics were identified in the Order.

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16. The Third Order concludes that Premera's Form A Statement will not be considered complete until the Commissioner is "satisfied that Prremera has supplied all the information needed to address the statutory considerations." Third Order at 6.

17. The Third Order states:

> I specifically want Premera to further explain the nature and effects of its proposed transaction in light of any questions or problems raised by the OIC Staff and its experts. I will consider such responsive reports as further supplementing Premera's [Form A] Statement.

Third Order at 7 (emphasis added).

18. The Third Order concludes that the 60-day timeframe set forth in the Holding Company Act for the Commissioner to make a decision on the Form A Statement is "directory and permissive," not a "mandatory requirement." Third Order at 9.

19. Premera timely sought review by this Court of the Commissioner's Third Order.

Jurisdiction

20. This Court has jurisdiction over Premera's Petition for Judicial Review pursuant to chapter 34.05 RCW. The Third Order finally determines and impairs Premera's legal right to a prompt determination on its Form A Statement, and the effects of the Third Order are final with respect to the timing of the decision on Premera's Form A Statement.

Errors of Law in the Commissioner's Orders

21. The Third Order erroneously confuses the prescribed contents of the Form A Statement with other information the Commissioner may need to make his decision. The contents of a Form A Statement are defined by statutes and regulations. The

The Commissioner has authority to declare whether a Form A statement is complete.

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completeness of a Form A Statement is to be judged solely by its conformity with those sections of the Holding Company Acts and implementing regulations that define the requirements for a complete Form A Statement. *See* RCW 48.31B.015(2)(a)-(l); RCW 48.31C.030(2)(a)-(l); WAC 284-18A-350; WAC 284-18A-910.

22. The Third Order improperly predicates completion of the Form A Statement upon resolution of "questions or problems raised by the OIC Staff and its experts." Third Order at 7. A complete Form A Statement does not include information adduced during the agency's discovery, investigation, and examination related to the application. Data requests or discovery by the OIC and its consultants in connection with their review and examination of Premera's Form A Statement do not constitute part of the Form A filing.

23. The Third Order erroneously adopts the conclusion in the First Order that the Form A Statement will not be considered "complete until the adjudicative hearing has concluded and the administrative record has closed." First Order at 2. A complete Form A Statement does not include the administrative record. The law makes a clear distinction between the administrative record of the Commissioner's deliberations on whether to approve the transaction detailed in a Form A Statement (e.g., information elicited during an administrative hearing) and the contents of the Form A filing itself.

24. The Third Order erroneously adopts the conclusion that the 60-day period for decision begins to run after the adjudicative hearing has been completed. The Holding Company Acts require the agency to complete the review process, including any hearing, and reach a decision on whether to approve the Form A Statement within 60 days after the Form A Statement is complete. RCW 48.31B.015(4)(b); RCW 48.31C.030(4). The 60-

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day decision deadline prescribed by the Holding Company Acts runs from the completeness of the Form A, not from the end of the adjudicative hearing.

25. The Third Order is erroneous as a matter of law in stating that the 60-day timeframes set forth in the Holding Company Acts are "directory and permissive." The Holding Company Acts' language is ~~mandatory, and~~ clear. The agency must comply with the statutory deadlines. The agency has no authority to interpret the plain language of the Holding Company Acts in a manner that alters or amends the statute.

26. The Third Order fails to comply with the statutory requirement that the Commissioner must promptly notify the person filing a Form A Statement of any deficiencies in the Form A Statement and indicate with specificity what additional information is required to make the filing complete. The Commissioner's declaration in the Third Order that the Form A Statement is incomplete ~~is insufficient and invalid as a matter of law~~ does not provide sufficient specificity to meet the requirements of RCW 48.31C.030(4).

II. DECLARATORY RELIEF

Pursuant to the Court's authority under RCW 34.05.574 to grant declaratory relief on a petition for review of agency action brought under RCW 34.05.570, the Court declares that:

1. The Holding Company Acts require a decision by the Commissioner within 60 days after the Form A Statement is complete.

2. The Third Order erroneously interprets and applies the Holding Company Acts for the reasons set forth in paragraphs 21-26 above.

3. The Third Order ignores explicit statutory provisions that define the content of a Form A Statement and imposes additional requirements that are both open-ended and indeterminate. The Third Order fails to identify deficiencies in the Form A Statement

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with sufficient specificity. ~~The Third Order undermines the legislative mandate for~~ a ~~decision within 60 days after the Form A Statement is complete~~.

4. By failing to inform Premera "with specificity" what information is needed to complete the Form A Statement, the Third Order unlawfully resulted in an endless loop of questions and requests to Premera. When the Commissioner issues a declaration of incompleteness and requests additional information, subsequent notices of filing deficiencies (if any) must be limited to the applicant's failure to satisfy deficiencies identified in the initial declaration. The Commissioner may not raise new filing deficiencies in subsequent notices. Any other interpretation would render the statutory tolling provisions meaningless.

5. Under the Health Care Service Contractors Act, the Form A Statement is "deemed complete" 60 days after receipt unless the Commissioner declares the statement to be incomplete, in which case the Commissioner must "promptly notify the person filing the statement of the filing deficiencies and shall set forth with specificity the additional information required to make the filing complete." RCW 48.31C.030(4). Because the Commissioner failed to meet the statutory requirements for a valid declaration of incompleteness, the Form A Statement is deemed complete as a matter of law.

6. By interpreting the Holding Company Act in a manner that ignores the standards for judging the Form A Statement "complete" and that defeats the statutory 60-day deadline for a decision on the statement, the agency has acted outside the scope of its delegated authority.

7. Premera is aggrieved and adversely affected by the Third Order because (a) the agency interpretation of the law ignores the statutory and regulatory criteria for determining whether Premera's Form A Statement is complete and jeopardizes Premera's

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statutory right to an administrative decision within 60 days; (b) Premera's interests are among those the agency is required to consider in taking action; (c) Premera is prejudiced by the Third Order because the proposed reorganization is time-sensitive and because Premera has been exposed to monetary harm, including the expenses related to payments to consultants engaged by the agency under RCW 48.31B.015(4)(c) and RCW 48.31C.030(5)(b); and (d) a judgment in favor of Premera is necessary to redress that prejudice. *See* RCW 34.05.530.

III. REMAND TO AGENCY WITH INSTRUCTIONS

Pursuant to the Court's authority under RCW 34.05.574 to order an agency to take action required by law upon a petition for review of agency action, this matter is remanded to the Commissioner with instructions to issue a decision pursuant to RCW 48.31C.030 and RCW 48.31B.015 within 60 days of September 5, 2003, unless Premera agrees to a later date for the issuance of the Commissioner's decision, unless no later than Sept. 10, 2003, the Commissioner identifies with specificity those deficiencies in the Form A statement that were identified prior to NOV 26 2002 that still remain outstanding

~~IV. CONTINUING JURISDICTION~~

~~The Court will retain jurisdiction of this matter until the Commissioner has issued his decision on Premera's Form A Statement.~~

IT IS SO ORDERED.

ENTERED this 5th day of September, 2003.

The Honorable Paula Casey

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